

GRAHAM COUNTY UTILITIES, INC. WATER DIVISION

P.O. DRAWER B PIMA, ARIZONA 85543

W-02527A-06-0505

DOCKET NO. W-02527A-06-

Before the

ARIZONA CORPORATION COMMISSION

APPLICATION FOR APPROVAL OF LONG-TERM DEBT

Arizona Corporation Commission DOCKETED

AUG 0 8 2006

DOCKÉTED BY Well August 2006

P.O. Drawer B Pima, Arizona 85543

Serving The Beautiful Gila Valley In Southeastern Arizona Telephone (928) 485-2451 FAX (928) 485-9491

Arizona Corporation Commission ATTN: Docket Control Center 1200 West Washington, Room 130 Phoenix, Arizona 85507

July 27, 2006

RE: Application for Financing for improvements in the Pima area in Graham County, Arizona.

Docket No. W-02527A-06-

- 1. Graham County Utilities, Inc- Water Division requests permission to incur additional long-term debt of \$972,000 for new wells and new water storage facilities in the Pima area and refinance \$128,000 of CFC long-term debt for a new loan totaling \$1,100,000. The current interest rate on the CFC loan to be refinanced is 7.45% with a maturity date of July 12, 2026.
- 2. USDA Rural Development will also provide a grant not to exceed \$969,620.
- 3. This project is necessary to comply with the new lower standards for arsenic as well as to develop new water sources to keep up with the demand of our current water users. The loan will be for a period of 40 years with level debt service at 4.375 percent interest rate.

The money will be borrowed over a period of one year after construction begins and funds will be received as soon as bills are submitted to Rural Development for expenditures incurred.

The following attachments are included for your review:

- 1. A copy of the Letter of Conditions and request for Obligation of funds from Rural Development to loan us the money needed.
- 2. September 2005 audited financial statements.
- 3. Preliminary Engineering Report.
- 4. Public notice of environments impact published in local paper.
- 5. Board resolution authorizing the project.
- 6. Schedule showing source of funds to service new debt.

We feel this is the best option available to comply with the new Arsenic requirements and to provide for current water needs. It is anticipated that this project will resolve the arsenic problem by blending the new water source with the existing source and there-by Graham County Utilities can continue to deliver safe drinking water to our customers with-out raising the rates.

Sincerely

Steve Lines

General Manager

Graham County Utilities

twe Lines





United States
Department of
Agriculture
Rural Development

658 N. Bisbee Avenue Willcox, AZ 85643 (520) 384-3529 FAX: 384-5207 (602) 280-8705 TDD

June 13, 2006

Graham County Utilities, Inc. PO Drawer B Pima, AZ 85543

Attn: Larry Morris

RE: Letter of Conditions (Water Wells & Storage Project)

Dear Mr. Morris

This letter establishes the conditions which must be understood and agreed to before further consideration may be given to the application for financial assistance on the Water Wells & Storage Project for Graham County Utilities, Inc. (Applicant). The State and Area Staff of USDA, Rural Development will administer the loan and grant on behalf of the Rural Utilities Service, RUS. Any changes in project cost, source of funds, scope of services, or any other significant changes in the project must be reported to and approved by the USDA, Rural Development by written amendment to this letter. Any changes not approved by RUS shall be cause for discontinuing processing of the application.

This letter is not to be considered as approval of the loan and grant application or as a representation as to the availability of funds. The docket may be completed on the basis of an RUS loan not to exceed \$1,120,000 and a Colonia Grant not to exceed \$969,620. The RUS financing is contingent on the Applicant contribution of \$77,000 for this project.

If RUS makes the loan, you may make written request that the interest rate be the lower of the rate in effect at the time of loan approval or the time of loan closing. If you do not request the lower of the two interest rates, the interest rate charged will be the rate in effect at the time of loan approval. The loan will be considered approved on the date a signed copy of Form RD 1940-1 - "Request for Obligation of Funds", is mailed to you. If you want the lower of the two rates, your written request should be submitted to USDA, Rural Development as soon as practicable. In order to avoid possible delays in loan closing, such a request should ordinarily be submitted at least 30 calendar days before loan closing.

Please complete and return the attached Form RD 1942-46 - "Letter of Intent to Meet Conditions", and Form 1940-1 - "Request for Obligation of Funds", if you desire that further consideration be given your application. The "Letter of Intent ..." must be executed within three

(3) weeks from the date of this letter or it becomes invalid, unless a time extension is granted by USDA -- Rural Development.

Also, submit a schedule showing completion dates of the final plans and specifications and a schedule for completion of the final bidding documents, start of construction and project completion.

The completion and execution of these forms, or any other form required by RUS, must be authorized by an appropriate resolution.

If conditions set forth in this letter are not met within 150 days from the date hereon, RUS reserves the right to discontinue processing the application.

In signing Form RD 1942-46 - "Letter of Intent to Meet Conditions", you are agreeing to the following:

1. REPAYMENT SCHEDULE

The Loan will be scheduled for repayment over a period not to exceed 40 years as described on the Promissory Note. The interest rate will be 4.375 percent. Interest only payment will be due 12 months from the day of loan closing. The estimated monthly payments amortized over the remaining 39 years will be approximately \$4,996.00 as evidenced by the Promissory Note.

Monthly payment will be made by participating in the PRE-AUTHORIZED DEBIT (PAD) payment process. A PAD will allow for your payment to be electronically debited from your account on the day your payment is due. A PAD authorization form is attached for your use.

2. **PROJECT FUNDING**

Loan and grant funds will be used as follows:

| PURPOSE | RUS LOAN | RUS GRANT | <u>Applicant</u> | TOTALS |
|----------------------|--------------------|---|------------------|------------------------|
| Wells | 535,500 489,500 | 849,620 | 77,000 | \$1,385,120 566,500 |
| Storage Refinance | 130,000 | A second of the | | 130,000 |
| Engineering | | \$120,000 | | 120,000 |
| Totals | 1,120,000 | 969,620 | 77,000 | 2,201,620 |

3. NUMBER OF USERS

The Applicant must certify that there will be at least 1,084 service connections at completion of the project. USDA, Rural Development will authenticate the number of users prior to loan closing, or at the start of construction.

4. RATES AND CHARGES

- A. Rates and Charges and Assessments must be adequate to meet the cost of maintaining and operating the system and meeting the required bond servicing requirements.
- B. User rates at project completion will be at least: \$41.03 per month per Equivalent Dwelling Unit (EDU).

5. **RESERVES**

As part of this RUS loan proposal, you must establish and fund monthly a debt service reserve fund equal to 10% of the monthly payment each month over the life of the loan until you accumulate one years payment. This reserve is required to establish an emergency fund for maintenance and repairs and debt repayment should the need arise. Ten percent of the proposed loan installment would equal \$506.00 per month.

6. <u>SECURITY REQUIREMENTS</u>

The loan to the applicant will be secured by a first position Form 1927-1, "Real Estate Deed of Trust" on the real property owned by Graham County Utilities. The applicant will provide preliminary title report for the amount of the proposed loan as further evidence of meeting the real estate security position requirement.

The following security documents will be executed at loan closing:

- (a) Form RD 440-22, "Promissory Note".
- (b) OGC-38(A) (AZ), "An Assignment of Income and Assessments". Article 9 of the UCC as amended, effective July 1, 2001, allows RUS to file financing statements and related documents without signatures from the Applicant.
- (c) RUS Bulletin 1780-28, "Loan Resolution Security Agreement".
- (d) RUS Bulletin 1780-12, "Association Water or Sewer Agreement",
- (e) Security Agreement will be executed.
- (f) UCC Financing Statement will be executed and filed with the Secretary of State.
- (g) Form RD 1927-1 AZ, "Real Estate Deed of Trust".

7. <u>ORGANIZATION</u>

The Applicant though its attorney shall provide a legal opinion regarding the validity of the corporation which is to include its legal authority under the Arizona Revised Statutes necessary for the corporation for operation, and maintaining the facility and for obtaining and offering security for the proposed loan.

8. BUSINESS OPERATION

- A. RD Bulletin 1780-28 "Loan Resolution Security Agreement" (copy attached), will be signed at loan closing. This form repeats some covenants contained in this Letter of Conditions, as well as establishing several additional requirements. The Applicant should carefully review this document and if questions arise, should contact USDA, Rural Development for clarification before its adoption.
- B. The Applicant will adhere to policies as outlined in Section 1780.47 of RUS Instruction 1780, dealing with borrower accounting, financial reporting, auditing, and bank accounts (copy attached). The annual audit will substitute for the quarterly reports. An annual audit report will be required. The report that must be prepared in accordance with OMB Circular A-133 will be required annually thereafter. <u>USDA must review and approve the Auditing Agreement and Accounting System prior to loan closing.</u>
- C. The loan will be subject to the provisions of equal opportunity in employment for construction and nondiscrimination accordance with Title VI of the Civil Rights Act of 1964. To this end, the Applicant must, by appropriate resolution, authorize the execution of, and execute, Form RD 400-1 "Equal Opportunity Agreement", and Form RD 400-4 "Assurance Agreement", attached hereto.
- D. The Applicant agrees to maintain rates as necessary to provide for operation and maintaining, and managing the facility, and providing for its continued availability and use at reasonable rates and terms. This responsibility shall be exercised by the Applicant even though the facility may be operated, maintained, or managed by a third party under contract, management agreement, or written lease.
- E. At no later than loan closing, Applicant will be required to furnish a prior approved management plan to include, as a minimum, provisions for management, maintenance, miscellaneous services, billing, collection, bookkeeping, making and delivering required reports and audits.

9. **INSURANCE AND BONDING**

- A. <u>Property Insurance</u>. As provided in RUS Instruction 1780, Section 1780.39 (g), fire and extended coverage will be carried on all above ground structures, including Applicant owned equipment, machinery, and furnishings housed therein. This includes pumps and electrical equipment, but it does not include water reservoirs, standpipes, elevated tanks, and other noncombustible materials used in treatment plants, clarification units and the like.
- B. <u>Workers Compensation.</u> Applicant will be required to carry suitable Workers Compensation Insurance for all its employees in accordance with applicable Arizona Laws.
- C. <u>Liability and Property Damage Insurance</u>. Applicant will be required to carry suitable insurance in an amount acceptable to USDA -- Rural Development. The insurance company must provide USDA, Rural Development with a 15-day notice of cancellation.

- D. <u>Fidelity Bonds</u>. Applicant will provide fidelity bond coverage for all persons who have access to funds. Coverage may be provided either for all individual positions or persons, or through "blanket" coverage providing protection for all appropriate employees and/or officials. The amount of coverage required by USDA, Rural Development will normally approximate the total annual debt service requirements for the USDA, Rural Development loans. Form RD 440-24, "Position Fidelity Bond Schedule" (copy attached) may be used.
- E. <u>Flood insurance</u>. Applicant will carry flood insurance on any above ground structures located in designated flood prone areas.
- F. <u>Insurance Approval by USDA -- Rural Development.</u> Applicant will be required on an annual basis to provide to this office evidence of the above insurance coverage(s). The proposed coverage must be approved in advance by USDA -- Rural Development.

10. OBTAINING ADEQUATE, CONTINUOUS, AND VALID RIGHTS-OF-WAY FOR THE CONSTRUCTION, OPERATION, AND MAINTENANCE OF ITS FACILITIES

The Applicant will submit the following documentary evidence to the USDA -- Rural Development, prior to advertising for construction bids:

- A. A copy of the form of right-of-way instrument to be used if it differs from Form RD 442-20 "Right-of-Way Easement" (copy attached). Rights-of-way with restrictive provisions should be accepted only in very unusual circumstances. Whenever the form of the instrument differs from Form RD 442-20 or contains special provisions that are required by either the Applicant or the grantor, copies of such instruments will be submitted to the USDA, Rural Development for review prior to acceptance and recording. Either specific rights-of-way or general rights-of-way containing only a description of the tract or parcel of land affected may be used where applicable. The Applicant will submit copies of the final, executed documents.
- B. A certificate by a duly authorized official of the Applicant that it has obtained and presently holds adequate and sufficient legal title to all rights-of-way, permits, licenses, and other authorizations deemed necessary by the Applicant, its engineer and attorney for an uninterrupted right-of-way for the construction, operation and maintenance of the facilities. Please use Form RD 442-21 "Right-of-Way Certificate", (copy attached).
- C. A right-of-way map showing the location of all structures, pipelines, wells, and the like. When completed, the map should show that the rights-of-way are continuous with no gaps. Rights-of-way acquired by use or adverse possession will be shown by some distinctive color. This map will be prepared by the Applicant's engineer, and it will bear the signature of the engineer.
- D. An opinion of the Applicant's attorney relating to the adequacy and legal sufficiency of the rights-of-way covered by the "Right-of-Way Certificate" and the right-of-way map. Use Form RD 442-22 "Opinion of Counsel Relative to Rights-of-Way" (copy attached), to the

extent possible. Counsel for the Applicant is hereby advised that USDA --Rural Development requires written consents to the granting of easements across private land from prior lien holders. The Applicant's legal counsel will be responsible for obtaining any and all such consents.

11. PLANNING AND PERFORMING DEVELOPMENT

- A. Performance of Construction Services will be authorized by use of the Funding Agency Edition of the Engineers Joint Contract Document Committee (EJCDC) standard contract documents. Sample copies can be found in the Rural Development website at http://www.usda.gov/rus/water/ees/englib/contract.htm. The actual copies of the EJCDC documents must be purchased in electronic format from one of EJCDC sponsor organizations listed in the website. The consulting engineer should refer to the RUS Bulletin 1780-26 for instructions on any modifications for construction contracting. We encourage you to contact Rural Development should any questions arise on the use of these documents.
- B. The engineer should not be authorized to commence work on final plans and specifications until a determination has been made that the project can be planned and constructed within the estimated cost as shown in Item 2, "Project Funding", of this letter. When this determination has been made, USDA, Rural Development shall be so advised by letter. The engineer may then proceed to develop final plans and specification that must be approved in writing by the Arizona Department of Environmental Quality, and USDA, Rural Development prior to advertising for bids.
- C. The project shall not be advertised for construction bids until all easements and enforceable options have been obtained, final design and specifications have been approved by USDA, Rural Development and total funds are committed or available for the project.
- D. Contracts will not be awarded for at least a week from the date bids are opened. During this week, the consulting engineer will tabulate and review bids, investigate the successful bidder, and submit a written recommendation. This information will be reviewed by USDA -- Rural Development, which must concur in writing before the award of contract is made.
- E. PRIOR to issuance of the NOTICE TO PROCEED, the applicant shall obtain all required construction reviews, approvals, and permits required by jurisdiction of the local government, county, state, or other federal agencies. The applicant through its consulting engineer shall provide a written certification to Rural Development that all reviews, approvals and permits for construction have been issued and are currently in effect.
- F. Resident Inspection. Full-time resident inspection is required for all construction unless a written exception is made by the Agency upon written request of the owner. Unless otherwise agreed, the resident inspector will be provided by the consulting engineer. Prior to the preconstruction conference, the consulting engineer will submit a resume of qualifications of the resident inspector to the owner and to the Agency for acceptance in writing. If the owner provides the resident inspector, it must submit a resume of the inspector's qualifications to the project engineer for comments and the Agency for acceptance in writing prior to the

preconstruction conference. The resident inspector will work under the technical supervision of the project engineer and the role and responsibilities will be defined in writing.

12. **DISBURSEMENT OF PROJECT FUNDS**

- A. Should the Applicant be unable to secure interim financing at reasonable rates and terms, USDA, Rural Development multiple advances will be utilized in accordance with RUS Instruction 1780.45.
- B. The Applicant will be expected to acknowledge receipts of wire transfers as requested by USDA, Rural Development. If not acknowledged, funds control tracking may be affected, and processing of future pay estimates/reimbursements by USDA, Rural Development may be delayed.
- C. During construction, the Applicant shall disburse project funds in a manner consistent with Section 1780.45 (e), of RUS Instruction 1780. Form RD 1924-18, "Partial Payment Estimates" or similar form approved by USDA -- Rural Development, shall be used for the purpose of documenting periodic construction estimates, and shall be submitted to USDA, Rural Development for review and acceptance. Prior to disbursement of funds the Applicant and USDA, Rural Development will review and approve each payment estimate. All bills and vouchers must be approved by USDA, Rural Development prior to payment by the Applicant.
- D. WIFA loan funds and applicant contributions shall be considered as the first funds expended. The USDA loan funds shall be considered the second funds expended. USDA grant funds shall be the last funds expended. After providing for all authorized costs, any remaining USDA project funds will be considered USDA grant funds and refunded to USDA.
- E. Monthly audits of the Applicant's construction account records may be made by USDA, Rural Development representatives.
- F. A supervised bank account will not be used. However, USDA, Rural Development must monitor the use of funds during development of this project.
- G. It should be understood that USDA, Rural Development is under no obligation to provide additional funds to meet an overrun in construction costs.

13. OTHER CONDITIONS

A. An Environmental Report has been reviewed by the USDA, Rural Development State Director in accordance with RD Instruction 1794 and the National Environmental Policy Act. USDA, Rural Development has determined that an Environmental Impact Statement is not needed.

- B. In the event that an item of archaeological significance is encountered during the project, the Applicant is to comply with the National Historic Preservation Act of 1966.
- C. Attached is a copy of RUS Bulletin 1780-12, "Water and Waste System Grant Agreement", for your review. You will be required to execute a completed form at the time of grant closing.
- D. The Applicant will be required to conform to any and all state and local laws and regulations affecting this type of project. It is the Applicant's responsibility to work with other regulatory agencies in obtaining their approvals. Any additional financing cost that may result from the failure to timely obtain these approvals will have to be borne by the Applicant.
- E. Written evidence is to be submitted to show the proposed project is consistent with the requirements of the Arizona Department of Environmental Quality.
- F. The Applicant will comply with Section 504 of the Rehabilitation Act of 1973, as amended (29 US 794), which provided that no handicapped individual, solely by reason of their handicap, be excluded from use of any facility receiving USDA, Rural Development assistance.
- G. Additional forms and requirements (copies attached).
 - 1. Form RD 400-1 "Equal Opportunity Agreement"
 - 2. Form RD 400-4 "Assurance Agreement"
 - 3. Form RD 1910-11 "Applicant Certification Federal Collection Policies for Consumer or Commercial Debts".
 - 4. Form AD-1049 "Certification Regarding Drug-Free Workplace requirements (Grants) Alternative I For Grantees Other Than Individual".
 - 5. Form AD-1047 "Certification Regarding Debarment, Suspension, and Other Responsibility Matters Primarily Covered Transaction".
 - 6. Exhibit A-I to RD Instruction 1940-Q, "Certification for Contracts, Grants and Loans" (copy attached). Certification required in connection with lobbying activities.
- H. This loan will be subject to the provisions of equal opportunity and nondiscrimination in employment for construction, in accordance with Title VI of the Civil Rights Act of 1964.
- I. RD Instruction 1780 outlines the policies and procedures for making the proposed loan and grant. Additional requirements not specifically required in the Letter of Conditions must also be met. (Copies attached) The applicant should review the attached

instructions and, should questions arise, contact USDA-Rural Development before loan closing.

- J. Professional Services Agreements shall be executed and approved by USDA before loan closing.
- K. Vulnerability Assessments and Emergency Response Plans (VA &ERP) In accordance with the Bioterrorism Preparedness and Response Act of 2002, Public Law 107-188 (Bioterrorism Act), you required to assess your system for vulnerability to an act of bioterrorism and to develop an emergency response plan to secure the public's health in the event of terrorism. A certificate of the completion of the assessment and the development of an emergency response plan must be provided to USDA/Rural Development prior to loan closing.

14. GRADUATION REQUIREMENTS

USDA, Rural Development loans are meant to be temporary source of credit and if at some future date, it appears that Borrower is able, the Borrower will be requested to refinance the loan with other lenders. The Borrower will be expected to comply with this requirement as evidenced by the legally enforceable clause contained in the RD Bulletin 1780-27 - "Loan Resolution" (Copy attached).

15. <u>CLOSING INSTRUCTIONS</u>

This loan and grant will be closed subject to the availability of funds, USDA Rural Development Instruction 1780, this Letter of Conditions, and any additional closing instructions from the USDA Office of General Counsel

Respectfully yours,

LEONARD GRADILLAS, Community Program Director

Attachments:

Form 1940-1, "Request for Obligation of Funds"

Form RD 1942-46 - "Letter of Intent to Meet Conditions"

Form RD 400-1 - "Equal Opportunity Agreement"

Form RD 400-4 - "Assurance Agreement"

Form FHA 440-24 - "Position Fidelity Schedule Bond Declarations"

Form RD 442-20 - "Right-of-Way Easement"

Form RD 442-21 - "Right-of-Way Certificate"

Form RD 442-22 -- "Opinion of Counsel Relative to Rights-of-Way"

Form RD 440-11 -- "Estimate of Funds Needed"

Form RD 1924-18 - "Partial Payment Estimate"

Form RD 442-2 - "Statement of Budget, Income and Equity"+

Form RD 1942-19 - "Agreement for Engineering Services"

RUS Bulletin 1780-12, "Water and Waste System Grant Agreement"

RUS Instruction 1780 Subpart C and RUS Bulletins 13 & 14

Form AD-1047 - "Certification Regarding Debarment ..."

Form RD 440-22, "Promissory Note".

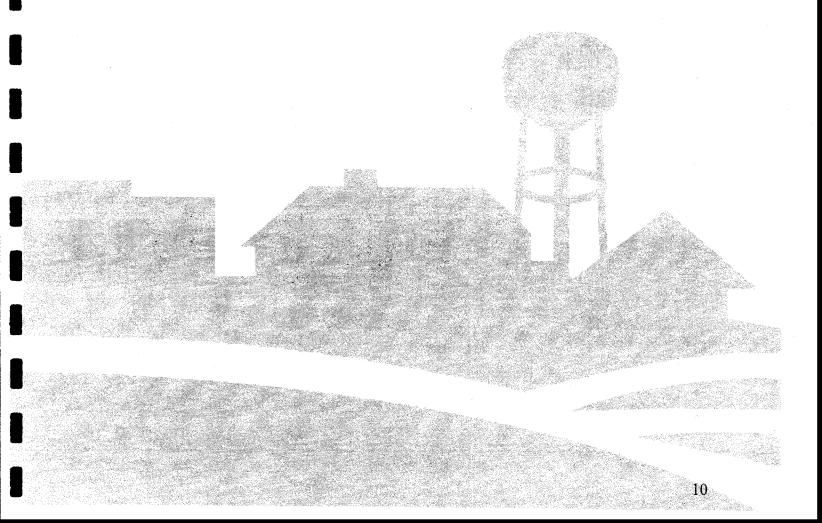
OGC-38(A) (AZ), "An Assignment of Income and Assessments". Article 9 of the UCC as amended, effective July 1, 2001, allows RUS to file financing statements and related documents without signatures from the Applicant.

RUS Bulletin 1780-28, "Loan Resolution Security Agreement".

Security Agreement will be executed.

UCC Financing Statement will be executed and filed with the Secretary of State.

Form RD 1927-1 AZ, "Real Estate Deed of Trust".



USDA-RD Form RD 1940-1 (Automated 8-97)

REQUEST FOR OBLIGATION OF FUNDS

| INSTRUCTIONS-TYPE IN CAPITALIZED ELITE TYPE IN SPACES MARKED Complete Items 1 through 30 and applicable Items 31 through 43. See FMI. | | | | | | |
|--|---|---|--|--|--|--|
| 1. CASE NUMBER | LOAN NUMBER | FISCAL YEAR | | | | |
| ST CO BORROWER ID 02 005 860626208 | . | | | | | |
| 2. BORROWER NAME | 3. NUMBER NAME FIELDS | | | | | |
| GRAHAM COUNTY UTILITIES INC | 1 1, 2, or 3 from Item 2) | | | | | |
| | 4. STATE NAME | | | | | |
| | Arizona | | | | | |
| | 5. COUNTY NAME | | | | | |
| | 005 Graham | · · · · · · · · · · · · · · · · · · · | | | | |
| | ER/LOAN INFORMATION B. COLLATERAL CODE | 9. EMPLOYEE | | | | |
| CLASSIFICATION 1 - WHITE 4 - HISPANIC 2 - BLACK 5 - A/PI 1 3 - AI/AN 1 - INDIVIDUAL FARM 2 - PARTNERSHIP WORKERS 3 - CORPORATION 7 - OTHER | 1 - REAL ESTATE 5 - LIVESTOCK ONI 2 - REAL ESTATE 6 - CROPS ONLY AND CHATTEL 7 - SECURED BY 3 - NOTE ONLY OR BONDS CHATTEL ONLY | RELATIONSHIP CODE | | | | |
| 10. SEX CODE 3-FAMILY UNIT 11. MARITAL STAT | | | | | | |
| 4 - ORGAN MALE OWNED 1 - MARRIED 3 - UNIV | MARRIED (INCLUDES DOWED/DIVORCED) 1 - YES 2 - NO | 2 1-YES 2-NO | | | | |
| 14. DIRECT PAYMENT | | 17. INTEREST CREDIT 1 - YES (FRO SFH ONLY) 2 - NO | | | | |
| 18. COMMUNITY SIZE | 19. DWELLING TYPE/USE O | F FUNDS CODE | | | | |
| 1 - 10,000 OR LESS (FOR SFH AND 2 - OVER 10,000 HPG ONLY) | (See FMI) | | | | | |
| COMPLETE FOR O 20. TYPE OF 21. PURPOSE CODE | BLIGATION OF FUNDS 22. SOURCE OF FUNDS | 23. TYPE OF ACTION | | | | |
| ASSISTANCE | | 1 - OBLIGATION ONLY 2 - OBLIGATION/CHECK REQUEST 1 3 - CORRECTION OF OBLIGATION | | | | |
| 061 (See FMI) 2 24. TYPE OF SUBMISSION 25. AMOUNT OF LOA | 26 AMO | UNT OF GRANT | | | | |
| 2 - SUBSEQUENT 2 - SUBSEQUENT \$ 1,100,000 | Į. | \$ 0.00 | | | | |
| 27. AMOUNT OF IMMEDIATE 28. DATE OF APPROVAL | 29. INTEREST RATE | 30. REPAYMENT TERMS | | | | |
| \$ 0.00 | 4.3750% | 40 | | | | |
| The state of the s | LE FAMILY HOUSING ONLY | | | | | |
| LI | W INCOME 33. ADJUS MIT-MAX. | TED FAMILY INCOME | | | | |
| 1 - VERY LOW 3 - MODERATE 2 - LOW 4 - ABOVE MODERATE | <u> </u> | | | | | |
| | LE. TAXES 37. NOTE Ind year | NSTALLMENT INELIGIBLE | | | | |
| 38. TYPE OF UNIT 1 - FARM TRACT 2 - NON-FARM TRACT | × . | | | | | |
| COMPLETE FOR COMMUNITY PROGRAM A | ND CERTAIN MULTIPLE-FAM | ILY HOUSING LOANS | | | | |
| 39. PROFIT TYPE 2 - LIMITED PROFIT | | | | | | |
| 3 1-FULL PROFIT 3-NONPROFIT COMPLETE FOR EM LOANS ONLY | COMPLETE FOR CRED | OIT SALE-ASSUMPTION | | | | |
| | 11. TYPE OF SALE | | | | | |
| (See FMI) | 2 - ASSUMPT 1 - CREDIT SALE ONLY 3 - CREDIT S | TION ONLY 4 - ASSUMPTION WIT SALE WITH SUB LOA SUBSEQUENT LOAN | | | | |
| FINANCE OFFICE USE ONLY | | FP LOANS ONLY | | | | |
| | 43. BEGINNING FARMER/RANG | CHER | | | | |
| MO DA YR | (See FMI) | <u> </u> | | | | |

GRAHAM COUNTY ELECT USDA RURAL DEVELOPMENT

PAGE 03

Ø 003

CERTIFICATION APPROVAL

For All Farmer Programs

BM, OL, FO, and SW Loans

This loan is approved subject to the availability of funds. If this loan does not close for any reason within 90 days from the date of approval on this document, the approval official will request applicable digibility information. The undersigned loan applicant agrees that the approval official will have 14 working days to review any updated information prior to submitting this document for obligation of funds. If there have been significant changes that may affect eligibility, a decision as to eligibility and feasibility will be made within 30 days from the time the applicant provides the necessary information.

If this is a loan aproval for which a lien and/or title search is necessary, the undersigned applicant agrees that the 15-working-day loan closing requirement may be exceeded for the purposes of the applicant's legal representatives completing title work and completing loan closing.

- 44. COMMENTS AND REQUIREMENTS OF CERTIFYING OFFICAL
- 45. I HEREBY CERTIFY that I am unable to obtain sufficient credit olsewhere to finance my actual needs at reasonable rates and terms, taking into consideration prevailing private and cooperative rates and terms in or near my community for loans for similar purposes and periods of time. I agree to use the sum specified herein, subject to and in accordance with regulations applicable to the type of assistance indicated above, and requested payment of such sum. I agree to report to USDA any material adverse changes, financial or otherwise, that occur prior to loan closing. I certify that no part of the sum specified herein has been received. I have reviewed the loan approval requirements and comments associated with this loan request and agree to comply with these provisions.

(For SFH & FP loans at eligible terms only) If this loan is approved, I elect the interest rate to be charged on my loan to be the lower of the interest rate in effect at the time of approval or loan closing. If I check "NO", the interest rate charged on my loan will be the rate specified in Item 29 of this form.

WARNING:

Whoever, in any matter within the jurisdication of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined under this title or imprisoned not more five years, or both."

| Date | CRAHAM COUNTY UTILITIES INC |
|--------------|-----------------------------|
| Date 6-21-06 | By: X She |
| | VICE - PRESIDENT |

46. I HEREBY CERTIFY that all of the committee and administrative determinations and certifications required by regulations prerequisite to providing assistance of the type indicated above have been made and that evidence thereof is in the docket, and that all requirements of pertinent regulations have been complied with. I hereby approve the above-described assistance in the amount set forth above, and by this document subject to the availability of funds, the Government agrees to advance such amount to the applicant for the purpose of and subject to the availability prescribed by regulations applicable to this type of assistance.

Date Approved:

Title Dance Signature of Approving Official)

47. TO THE APPLICANT: As of this date 6 30-06 per this is notice that your application for financial assistance from the USDA has been approved, as indicated above, subject to the availability of funds and other conditions required by the USDA. If you have any questions contact the County Supervisor or District Director.

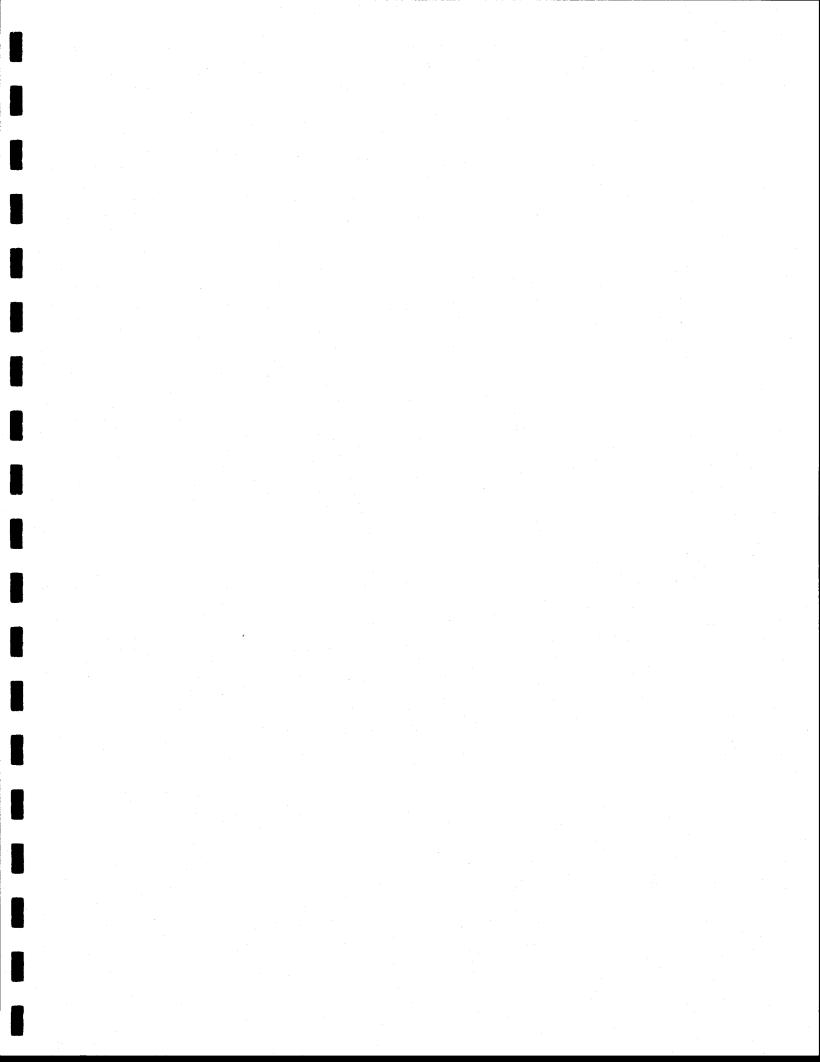
PIMA, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS



PIMA, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

GRAHAM COUNTY UTILITIES, INC. PIMA, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

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INDEPENDENT AUDITORS' REPORT

Board of Directors Graham County Utilities, Inc. Pima, Arizona

We have audited the accompanying balance sheets of Graham County Utilities, Inc., as of September 30, 2005 and 2004, and the related statements of income and accumulated margins (deficits), and cash flows for the years then ended. These financial statements are the responsibility of the cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Graham County Utilities, Inc. as of September 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a report dated October 27, 2005, on our consideration of Graham County Utilities, Inc.'s internal control over financial reporting and on its compliance with certain provision of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audits.

Bolinger, Segars, Silbert & Mars LLP

Certified Public Accountants

October 27, 2005

Exhibit A

BALANCE SHEET FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

ASSETS

| | Sen | tember 30, |
|--|---|--|
| | 2005 | 2004 |
| UTILITY PLANT | | |
| Plant in Service | \$ 4,917,312 | \$ 4,770,688 |
| Construction Work in Progress | 131,696 | 3,433 |
| Plant Acquisition Adjustment | 1,025,652 | 1,025,652 |
| 1 tant rodal state resident state st | \$ 6,074,660 | \$ 5,799,773 |
| Less: Accumulated Provision for Depreciation | | 7 - 7, 7, |
| and Amortization | 3,200,658 | 2,989,932 |
| | \$ 2,874,002 | \$ 2,809,841 |
| | + <u></u> | |
| OTHER PROPERTY AND INVESTMENTS | | |
| Investments in Associated Organizations | \$ 270,615 | \$ 278,018 |
| | · | |
| CURRENT ASSETS | | |
| Cash - General | \$ 19,124 | \$ 18,908 |
| Accounts Receivable (Less allowance for uncollectibles | | |
| of \$40,641 in 2005 and \$29,177 in 2004) | 129,710 | 66,977 |
| Underbilled Consumer Fuel Cost | 232,035 | |
| Accounts Receivable - Graham County Electric Cooperative | 202,000 | 178,723 |
| Materials and Supplies | 122,733 | 95,296 |
| Other Current and Accrued Assets | 31,149 | 38,287 |
| Total Current Assets | \$ 534,751 | \$ 398,191 |
| Total Current Assets | Φ <u>554,751</u> | Ψ <u>390,191</u> |
| DEFERRED CHARGES | \$ 60,900 | \$ 66,602 |
| | \$ 3,740,268 | \$3,552,652 |
| | | |
| | | |
| EQUITIES AND LIABILITIES | | |
| | | |
| MEMBERS' EQUITY | \$ 29.445 | \$ 29.160 |
| MEMBERS' EQUITY Memberships | \$ 29,445 124.813 | |
| MEMBERS' EQUITY | 124,813 | (2,023) |
| MEMBERS' EQUITY Memberships | • | (2,023) |
| MEMBERS' EQUITY Memberships | 124,813 | (2,023) |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT | 124,813 \$ 154,258 | (2,023) |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities | 124,813 \$ 154,258 | \$ (2,023) \$ 27,137 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities | \$\frac{124,813}{154,258}\$ | \$\frac{(2,023)}{27,137}\$\$ \$ 2,229,111 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable | \$\frac{124,813}{154,258}\$\$ \$2,109,830 89,834 | \$\frac{(2,023)}{27,137}\$ \$ 2,229,111 \$ 111,834 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities | \$\frac{124,813}{154,258}\$\$ \$\frac{2,109,830}{89,834}\$\$ \$\frac{131,100}{1100}\$\$ | \$\frac{(2,023)}{27,137}\$ \$\frac{2,229,111}{111,834}\$ \$164,544 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable | \$ 2,109,830 89,834 131,100 501,629 | \$ 2,229,111 111,834 164,544 509,939 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities | \$\frac{124,813}{154,258}\$\$ \$\frac{2,109,830}{89,834}\$\$ \$\frac{131,100}{1100}\$\$ | \$\frac{(2,023)}{27,137}\$ \$\frac{2,229,111}{111,834}\$ \$164,544 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities | \$ 2,109,830 89,834 131,100 501,629 | \$ 2,229,111 111,834 164,544 509,939 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities | \$ 2,109,830 | \$ 2,229,111 111,834 164,544 509,939 \$ 3,015,428 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt | \$ 2,109,830 | \$ 2,229,111 111,834 164,544 509,939 \$ 3,015,428 \$ 181,998 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other | \$ 2,109,830 | \$ 2,229,111 111,834 164,544 509,939 \$ 3,015,428 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop | \$ 2,109,830 | \$ 2,229,111 111,834 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost | \$ 2,109,830 | \$ 2,229,111 111,834 \$ 2,229,111 111,834 \$ 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 76,535 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost Customers' Deposits and Prepayments | \$ 2,109,830 | \$ 2,229,111 111,834 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost Customers' Deposits and Prepayments Accrued Payroll | \$ 2,109,830 | \$ 2,229,111 111,834 \$ 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 76,535 71,205 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost Customers' Deposits and Prepayments Accrued Payroll Accrued Taxes | \$ 2,109,830 89,834 131,100 501,629 \$ 2,832,393 \$ 182,944 103,853 314,433 75,160 3,487 59,291 | \$ 2,229,111 111,834 \$ 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 76,535 71,205 62,378 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost Customers' Deposits and Prepayments Accrued Payroll Accrued Taxes Accrued Interest | \$ 2,109,830 89,834 131,100 501,629 \$ 2,832,393 \$ 182,944 103,853 314,433 75,160 3,487 59,291 14,449 | \$ 2,229,111 111,834 \$ 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 76,535 71,205 62,378 12,325 |
| MEMBERS' EQUITY Memberships Accumulated Margins (Deficits) LONG -TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Note Payable Less Current Maturities Graham County Electric Cooperative Note Payable Less Current Maturities USDA Rural Development Note Payable Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Graham County Electric Coop Overbilled Consumers Fuel Cost Customers' Deposits and Prepayments Accrued Payroll Accrued Taxes | \$ 2,109,830 89,834 131,100 501,629 \$ 2,832,393 \$ 182,944 103,853 314,433 75,160 3,487 59,291 | \$ 2,229,111 111,834 \$ 164,544 509,939 \$ 3,015,428 \$ 181,998 105,646 76,535 71,205 62,378 |

See accompanying notes to financial statements.

Exhibit B

STATEMENT OF INCOME AND ACCUMULATED MARGINS (DEFICITS) FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | September 30, | | |
|--|-----|---------------|---------------|-----------|
| | | 2005 | | 2004 |
| OPERATING REVENUES | \$_ | 3,575,368 | \$ | 3,294,237 |
| OPERATING EXPENSES | | | | |
| Purchased Gas | \$ | 1,846,966 | \$ | 1,629,487 |
| Power for Pumping | | 24,647 | | 33,811 |
| Operations | | 294,506 | | 299,383 |
| Maintenance | | 314,284 | | 348,767 |
| Consumer Accounts | | 235,543 | | 247,596 |
| Administrative and General | | 346,782 | | 318,822 |
| Depreciation and Amortization | | 210,726 | | 207,495 |
| Other Interest | | 36,889 | | 30,437 |
| Total Operating Expenses | \$_ | 3,310,343 | \$ | 3,115,798 |
| OPERATING MARGINS - BEFORE FIXED CHARGES | \$ | 265,025 | \$ | 178,439 |
| Interest on Long-Term Debt | _ | 169,880 | | 161,691 |
| OPERATING MARGINS - AFTER FIXED CHARGES | \$ | 95,145 | \$ | 16,748 |
| Capital Credits | _ | 14,840 | | 12,417 |
| NET OPERATING MARGINS | \$ | 109,985 | \$ | 29,165 |
| NONOPERATING MARGINS | | | | |
| Interest | _ | 16,851 | | 7,194 |
| NET MARGINS | \$ | 126,836 | \$ | 36,359 |
| ACCUMULATED (DEFICITS) - BEGINNING OF YEAR | | (2,023) | , | (38,382) |
| ACCUMULATED MARGINS (DEFICITS) - END OF YEAR | \$_ | 124,813 | \$_ | (2,023) |

Exhibit C

STATEMENT OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | September 30, | | r 30, |
|---|----------|---------------|------------|-----------|
| | - | 2005 | | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | |
| Net Margins | \$ | 126,836 | \$ | 36,359 |
| Adjustments to Reconcile Net Margins to | | | | |
| Net Cash Provided by (Used in) Operating Activities | | | | |
| Depreciation and Amortization | | 210,726 | | 207,495 |
| Capital Credits - Noncash | | (14,840) | | (12,417) |
| Overbilled Fuel Cost | | (308,570) | | (389,707) |
| Deferred Charges | | 5,702 | | 10,239 |
| Accounts Receivable | | (62,733) | | 2,202 |
| Inventories and Other Current Assets | | (20,299) | | 12,494 |
| Payables and Accrued Expenses | | 4,686 | | 27,572 |
| Net Payments to (from) - Graham County Electric Cooperative | | 493,166 | | (24,780) |
| Net Cash Provided by (Used in) Operating Activities | \$_ | 434,674 | \$_ | (130,543) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| Additions to Plant | \$ | (274,887) | \$ | (131,175) |
| Investments in Associated Organizations | | 22,226 | | 23,094 |
| Net Cash Used in Investing Activities | \$_ | (252,661) | \$_ | (108,081) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | |
| Advances from CFC | \$ | | \$ | 400,000 |
| Payments on Note Payable to AEPCO | | (23,833) | | (20,168) |
| Payments on Long-Term Debt to CFC | | (119,280) | | (105,248) |
| Payments on Long-Term Debt to GCEC | | (31,065) | | (28,856) |
| Payments on Long-Term Debt to USDA | | (7,904) | | (7,549) |
| Memberships | <u>.</u> | 285 | | 600 |
| Net Cash Provided by (Used in) Financing Activities | \$_ | (181,797) | \$ <u></u> | 238,779 |
| INCREASE IN CASH | \$ | 216 | \$ | 155 |
| CASH - BEGINNING OF YEAR | | 18,908 | | 18,753 |
| CASH - END OF YEAR | \$ | 19,124 | s | 18,908 |
| ONOTI END OF TEXT | - | 10,121 | ¥ | 10,000 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | | |
| Cash paid during the year for: | | | | |
| Interest on Long-Term Debt | \$_ | 169,880 | \$ | 177,338 |
| Federal Income Tax | \$= | 0 | \$ | 0 |
| | · = | | _ | |

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Graham County Utilities, Inc. is organized as a cooperative to provide gas and water utility services to customers in Graham County, Arizona. The cooperative was incorporated February 14, 1989, and began operations in November, 1989, with the purchase of assets and liabilities from two private utility companies. The cooperative has been granted exemption from Federal income taxes under Internal Revenue Code Section 501(c)(12).

Basis of Accounting

The cooperative accounts for assets, liabilities, income, and expenses separately for each utility service furnished. Separate accounting is maintained for the gas department and the water department.

Recognition is given to all services rendered and facilities provided by each department, as well as those services provided by Graham County Electric Cooperative, Inc. under the operating and management agreement executed by both cooperatives. These services are billed at predetermined rates. The accrual basis of accounting is followed in all departments.

Operating Revenues

Gas and water revenues are under the jurisdiction of the Arizona Corporation Commission.

The cooperative records revenues as billed to the customers on a monthly basis. Revenue is not accrued for utility services delivered but not billed at the end of each month. The unbilled and unrecorded revenue at September 30, 2005 and 2004, was estimated to be \$72,216 and \$46,755 in the gas department and \$39,979 and \$32,921 in the water department, respectively.

The cooperative's tariffs include an adjustment for flow-through of purchased natural gas costs. In order to match fuel costs and related revenues, costs billed in advance are recorded as overbilled consumers fuel cost and costs to be billed in the subsequent period are recorded as underbilled consumers fuel cost. For the years ended September 30, 2005 and 2004, the cooperative had overbilled (underbilled) of \$(232,035) and \$76,535, respectively.

Group Concentration of Credit Risk

The cooperative's headquarters is located in Pima, Arizona. The service area includes members located in Graham County, Arizona, and also includes retail service to the towns of Pima and Ft. Thomas, and wholesale services to Eden Water Company. The cooperative records a receivable for gas and water service as billed on a monthly basis. The cooperative requires a deposit from customers upon connection which is applied to any unpaid bills upon default. The deposit accrues interest annually at the rate of six percent. Deposits on hand totaled \$75,160 and \$71,205 at September 30, 2005 and 2004, respectively.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate.

NOTES TO FINANCIAL STATEMENTS

Inventories

Inventories which consist of construction materials and supplies are valued at average unit cost.

Federal Income Tax Status

The cooperative qualifies for tax exempt status under Internal Revenue Code section 501(c)(12) with more than 85% of income consisting of amounts received from members.

Allowance for Uncollectible Accounts

The cooperative uses the aging method to allow for uncollectible accounts receivable. During the year, management makes an evaluation of past due accounts to determine collectibility. The accounts deemed uncollectible are written off upon approval by the Board of Directors.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Assets Pledged

All assets are pledged as security for the long-term debt due the National Rural Utilities Cooperative Finance Corporation (CFC).

3. Utility Plant and Depreciation

Utility plant is stated at the original cost of construction including the construction costs incurred by the utility from which the corporation acquired plant in November 1989. Original cost includes the cost of contracted services, direct labor, materials, and overhead reduced by contributions in aid to construction received in connection with new construction.

Maintenance and repairs including the renewal of minor items of plant not comprising a retirement unit are charged to the appropriate maintenance accounts.

NOTES TO FINANCIAL STATEMENTS

Major classes of utility plant are summarized as follows:

| | | September 30, 2005 | | | | | _ | September 30, |
|---|----|--------------------|----|------------|----|-----------|-----|---------------|
| | | Gas | | Water | | | | 2004 |
| | • | Department | | Department | | Total | | Total |
| Utility Plant in Service | | | • | | | | | |
| Intangible | \$ | 42,522 | \$ | 37,708 | \$ | 80,230 | \$ | 80,230 |
| Production | | | | 475,536 | | 475,536 | | 457,892 |
| Transmission | | | | 983,468 | | 983,468 | | 983,468 |
| Distribution | | 2,794,186 | | 270,612 | | 3,064,798 | | 2,943,485 |
| General | | 103,832 | | 192,025 | | 295,857 | | 288,190 |
| Land and Land Rights | | 1,416 | | 16,007 | | 17,423 | | 17,423 |
| Total Plant in Service | \$ | 2,941,956 | \$ | 1,975,356 | \$ | 4,917,312 | \$ | 4,770,688 |
| Construction Work in Progress Utility Plant Acquisition | | 50,374 | | 81,322 | | 131,696 | | 3,433 |
| Adjustment | | 415,484 | • | 610,168 | • | 1,025,652 | _ | 1,025,652 |
| Total Utility Plant | \$ | 3,407,814 | \$ | 2,666,846 | \$ | 6,074,660 | \$_ | 5,799,773 |

Provision has been made for depreciation on straight-line composite rates as follows:

| | Gas | Water |
|---------------------|--------------|------------|
| | Department | Department |
| Production | | 4% |
| Transmission | | 4% |
| Distribution | | 4% |
| Gas Mains | 2.80% | |
| Services | 4.10% | |
| Meters - Regulators | 2.60% | |
| Structures | 2.30% | |
| General | 6.7% - 13.3% | 10% - 20% |

Depreciation accruals charged to expense for the periods ended September 30, 2005 and 2004, totaled \$210,726 and \$207,495, respectively.

A plant acquisition adjustment was created when Graham County Utilities, Inc. purchased the assets and liabilities of City Utilities, Inc. and General Utilities, Inc. The acquisition adjustment, representing the amount of the purchase price over the book value of the net assets acquired, amounted to \$415,484 in the gas department and \$610,168 in the water department. Plant acquisition adjustments are amortizable over the estimated useful life of the plant acquired. The corporation has elected to amortize these costs over a 25 year period. The annual charge to expense is \$16,619 in the gas department and \$24,407 in the water department.

NOTES TO FINANCIAL STATEMENTS

The plant acquisition costs and related provision for amortization at September 30, 2005, are summarized as follows:

| | <u></u> | Gas Department | | Water Department |
|---|---------|-------------------|-----|---------------------|
| Acquisition Adjustment Less: Amortization | \$_ | 415,485 | \$ | 610,168 |
| Prior Periods Current Year | \$ | 249,291 16,619 | \$ | 366,100 24,407 |
| | \$ | 265,910 | \$_ | 390,507 |
| Unamortized Adjustment | \$ | 149,575 | \$_ | 219,661 |

4. Investments in Associated Organizations

Investments in associated organizations consisted of the following:

| | September 30, | | | |
|---|---------------|---------|-------------|---------|
| | | 2005 | | 2004 |
| CFC | | | | - |
| Capital Term Certificates | \$ | 175,093 | \$ | 181,168 |
| Patronage Capital | | 88,395 | | 90,502 |
| Memberships | | 1,000 | | 1,000 |
| | \$ _ | 264,488 | \$_ | 272,670 |
| Graham County Electric Coooperative, Inc. | | | | |
| Patronage Capital | \$_ | 6,127 | \$ <u>_</u> | 5,348 |
| | \$_ | 270,615 | \$_ | 278,018 |

NOTES TO FINANCIAL STATEMENTS

5. Deferred Charges

Deferred charges consisted of the following:

| | September 30, | | |
|--------------------------|---------------|----------------------------|--|
| | 200 | 5 2004 | |
| Gas Department | | | |
| Rate Filing Costs | \$ 3,1 | 30 \$ 1,535 | |
| Unamortized Debt Expense | 30,6 | 18 <u>34,485</u> | |
| | \$ 33,7 | \$ 36,020 | |
| Water Department | | 1 | |
| Unamortized Debt Expense | \$ 27,1 | 52 \$ 30,582 | |
| · | 27,1 | 52 30,582 | |
| | \$ 60,9 | <u>00</u> \$ <u>66,602</u> | |

During 1998, the cooperative converted a CFC note to a lower interest rate of 7.1% for 15 years with a conversion fee of \$109,457. Amortization expense for the years ended September 30, 2005 and 2004, is \$7,297.

6. Memberships

Memberships are comprised of the following:

| | | Septe | mber 3 | 30, |
|---|-----|--------|--------|--------|
| | | 2005 | | 2004 |
| Class A Memberships Graham County Electric Cooperative, Inc., entitled to one vote | \$ | 5,000 | \$ | 5,000 |
| Class B Memberships All qualified members of Graham County Electric Cooperative, Inc., \$5 membership fee, entitled | | | | |
| to one vote per membership Class C Memberships All others who receive service, \$5 membership | | 19,780 | | 19,495 |
| fee, entitled to one vote per membership | _ | 4,665 | | 4,665 |
| | \$_ | 29,445 | \$_ | 29,160 |

NOTES TO FINANCIAL STATEMENTS

7. Accumulated Margins (Deficits)

This balance consists of net margins or (losses) as follows:

| | Dep | Gas partment | D | Water epartment | | Total |
|---------------------------|-----|-----------------|----|--------------------|-----|-----------|
| Calendar Year | | | | | | |
| 1989 | \$ | 23,321 | \$ | (694) | \$ | 22,627 |
| 1990 | | (30,746) | | 2,845 | | (27,901) |
| 1991 | | (91,410) | | (23,047) | | (114,457) |
| 1992 | | (41,115) | | (13,851) | | (54,966) |
| 1993 | | (64,937) | | 5,078 | | (59,859) |
| 1994 | | (46, 268) | | 26,494 | | (19,774) |
| 1995 | · (| 172,043) | | (28,602) | | (200,645) |
| 1996 | | (68, 293) | | (3,410) | | (71,703) |
| 1997 | | (65,806) | | (23,095) | | (88,901) |
| 1998 | | 225,309 | | 31,474 | | 256,783 |
| 1999 | | 97,405 | | 62,256 | | 159,661 |
| 2000 | | 1,467 | | 46,927 | | 48,394 |
| 2001 | | 39,062 | | 40,741 | | 79,803 |
| 2002 | | 61,124 | | 1,125 | | 62,249 |
| 2003 | | (5,764) | | 69,524 | | 63,760 |
| 2004 | | 62,759 | | 7,767 | | 70,526 |
| 2005 Nine Months | | 43,672 | | 37,579 | | 81,251 |
| | \$ | (32,263) | \$ | 239,111 | \$ | 206,848 |
| Patronage Capital Retired | | <u> </u> | | (82,035) | . • | (82,035) |
| | \$ | (32,263) | \$ | 157,076 | \$ | 124,813 |

The Board of Directors has adopted the policy of separating each department's net gains or losses for allocation purposes. Due to prior period net deficits, no patronage capital has been allocated from operations in the gas department. Patronage capital will be allocated when all deficits have been recovered. During the year ended September 30, 2005 and 2004, no retirements of patronage capital were made.

Under the mortgage agreement with CFC, until the equities or margins equal or exceed 30% of the total assets of the cooperative, the return to patrons of capital contributed by them is limited.

NOTES TO FINANCIAL STATEMENTS

8. Mortgage Notes - CFC

Following is a summary of long-term debt due CFC maturing September 30, 2014, June 30, 2026, and September 30, 2031:

| | September 30, | | | | |
|---|---------------|--------------|--|--|--|
| | 2005 | 2004 | | | |
| Fixed - 7.10% | \$ 1,012,695 | \$ 1,090,547 | | | |
| Variable (5.85% in 2005, 3.70% in 2004) | 342,776 | 366,713 | | | |
| Fixed - 7.45% | 483,510 | 492,999 | | | |
| Fixed - 4.30% | 390,049 | 398,052 | | | |
| | \$ 2,229,030 | \$ 2,348,311 | | | |
| Less: Current Maturities | 119,200 | 119,200 | | | |
| | \$ 2,109,830 | \$ 2,229,111 | | | |

Principal and interest installments on the above notes are due quarterly in amounts of approximately \$64,900. As of September 30, 2005, annual maturities of long-term debt due CFC for the next five years is as follows:

| 2006 | \$ 119,200 |
|------|------------|
| 2007 | 126,900 |
| 2008 | 135,100 |
| 2009 | 143,900 |
| 2010 | 153,200 |

The mortgages contain requirements requiring certain financial ratios to be maintained or exceeded. These requirements became effective during the calendar year ending December 31, 1992.

9. USDA Rural Development Note Payable

Following is a summary of long-term debt due USDA Rural Development:

| | September 30, | | | | | |
|--------------------------------|---------------|---------|-----|---------|--|--|
| | | 2005 | | 2004 | | |
| 5% Note Maturing March 2032 | \$ | 153,056 | \$ | 155,770 | | |
| 4.5% Note Maturing August 2035 | | 265,855 | | 269,989 | | |
| 4.5% Note Maturing July 2040 | | 91,024 | | 92,080 | | |
| • • | \$_ | 509,935 | \$ | 517,839 | | |
| Less: Current Maturities | - | 8,306 | | 7,900 | | |
| | \$_ | 501,629 | \$_ | 509,939 | | |

NOTES TO FINANCIAL STATEMENTS

Principal and interest installments on the above notes are due monthly in amounts of \$2,652. As of September 30, 2005, annual maturities of long-term debt due USDA Rural Development for the next five years are as follows:

| 2006 | | \$ | 8,306 |
|------|--|----|--------|
| 2007 | | | 8,700 |
| 2008 | | | 9,100 |
| 2009 | | | 9,500 |
| 2010 | | | 10,000 |

10. Graham County Electric Note Payable

During 1998, the cooperative financed an accounts payable due to Graham County Electric Cooperative. The total cost of \$500,000 is to be paid over 10 years in monthly payments including interest at the rate of 7.4%. The balance outstanding at September 30, 2005, is \$164,544. Annual maturities due to Graham County Electric Cooperative for the next five years are as follows:

| | | \$ 33,444 |
|--|--|--------------|
| | | 36,000 |
| | | 38,800 |
| | | 41,700 |
| | | 14,600 |
| | | \$ |

11. AEPCO Note Payable

During 1999, the cooperative obtained a zero interest loan from the Arizona Electric Power Cooperative, Inc. through the Rural Economic Development Program of RUS. The total loan was \$220,000, payable in monthly payments of \$1,833 for 120 months. The balance at September 30, 2005, is \$111,834. Annual maturities due to AEPCO for the next five years are as follows:

| 2006 | | \$ | 22,000 |
|------|--|----|--------|
| 2007 | | | 22,000 |
| 2008 | | | 22,000 |
| 2009 | | | 22,000 |
| 2010 | | | 22,000 |

12. Related Parties

Graham County Utilities, Inc. (GCU) is related by having substantially identical Boards of Directors and management with Graham County Electric Cooperative, Inc. (GCEC). GCEC provides administrative and general, management, operations, consumer accounting, and construction services to GCU under an operating and management agreement signed by both parties on June 20, 1989.

NOTES TO FINANCIAL STATEMENTS

GCEC is also the guarantor of the mortgage loan executed by GCU to CFC.

Intercompany balances between the two cooperatives are summarized as follows:

| | Septe | mber 30, |
|--|---------------------|--------------------|
| | 2005 | 2004 |
| Graham County Utilities, Inc. | | |
| Accounts Receivable (Payable) | \$ (314,433) | \$ 178,723 |
| Note Payable | (164,544) | (195,609) |
| Net Due to Affiliated Cooperative | \$ <u>(478,977)</u> | \$ <u>(16,886)</u> |
| Graham County Electric Cooperative, Inc. | | |
| Accounts Receivable (Payable) | \$ 314,433 | \$ (178,723) |
| Note Receivable | 164,544 | 195,609 |
| Net Due from Affiliated Cooperative | \$ <u>478,977</u> | \$ <u>16,886</u> |

13. Litigation

The cooperative is not involved in any litigation that would materially affect the financial statements.

ACCOMPANYING INFORMATION

INDEPENDENT AUDITORS' REPORT ON ACCOMPANYING INFORMATION

Our audits of the basic financial statements presented in the preceding section of this report were made for the purpose of forming an opinion on such financial statements taken as a whole. The accompanying information shown on pages 15 through 20 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Bolinger, Segars, Gilbert & Mars LLP

Certified Public Accountants

October 27, 2005

GRAHAM COUNTY UTILITIES, INC. GAS DEPARTMENT

Schedule 1

BALANCE SHEET SEPTEMBER 30, 2005 AND 2004

ASSETS

| | S. | | | otember 30, | | |
|---|-----|-------------------|-------------|-------------|--|--|
| | - | 2005 | CITIDE | 2004 | | |
| UTILITY PLANT | _ | | | | | |
| Plant in Service | \$ | 2,941,956 | \$ | 2,832,033 | | |
| Construction Work in Progress | | 50,374 | | 1,782 | | |
| Plant Acquisition Adjustment | _ | 415,484 | | 415,484 | | |
| | \$ | 3,407,814 | \$ | 3,249,299 | | |
| Less: Accumulated Provision for Depreciation | | | | | | |
| and Amortization | · | 1,745,656 | _ | 1,639,430 | | |
| | \$_ | 1,662,158 | \$ _ | 1,609,869 | | |
| OTHER PROPERTY AND INVESTMENTS AT COST OR STATED VALUE | | | | | | |
| Investments in Associated Organizations | \$_ | 147,282 | \$_ | 150,818 | | |
| CURRENT ASSETS Accounts Receivable (Less allowance for uncollectibles of \$31,111 in 2005 and \$21,324 in 2004) | \$ | 107,442 | \$ | 55,376 | | |
| Underbilled Consumers Fuel Cost | | 232,035 | | | | |
| Accounts Receivable - GCEC | | | | 2,535 | | |
| Materials and Supplies | | 78,458 | | 67,202 | | |
| Other Current and Accrued Assets | | 23,359 | | 28,726 | | |
| Total Current Assets | \$_ | 441,294 | \$ | 153,839 | | |
| Deferred Charges | \$_ | 33,748 | \$_ | 36,021 | | |
| | \$_ | 2,284,482 | \$_ | 1,950,547 | | |
| EQUITIES AND LIABILITIES | 3 | | | | | |
| MEMBERS' EQUITY | | | | | | |
| Memberships | \$ | 26,945 | \$ | 26,660 | | |
| Accumulated Deficits | Ψ. | (32,263) | • | (112,194) | | |
| Accumulated behalfs | \$ | (5,318) | \$ | (85,534) | | |
| | *- | (515.57 | · | \ | | |
| LONG -TERM DEBT | | | | | | |
| Note Payable - Graham County Electric Cooperative | \$ | 131,100 | \$ | 164,544 | | |
| CFC Mortgage Notes Less Current Maturities | _ | 1,391,511 | | 1,460,389 | | |
| | \$_ | 1,522,611 | \$ | 1,624,933 | | |
| | | | | | | |
| OUDDENT LIABILITIES | | | | | | |
| CURRENT LIABILITIES | æ | 102 244 | • | 100.065 | | |
| Current Maturities of Long-Term Debt | \$ | 103,344 82,796 | \$ | 100,965 | | |
| Accounts Payable - Other | | | | 85,897 | | |
| Accounts Payable - Graham County Electric Cooperative | | 314,398 | | 30,473 | | |
| Accounts Payable - Water Department | | 146,490 | | 76,535 | | |
| Overbilled Consumers Fuel Cost | | 38,682 | | 43,692 | | |
| Accrued Taxes Customers' Deposits and Prepayments | | 66,480 | | 63,370 | | |
| Accrued Payroll | | 2,878 | | 09,570 | | |
| Accrued Interest | | 12,121 | | 10,216 | | |
| Total Current Liabilities | \$ | 767,189 | \$ - | 411,148 | | |
| Total Current Elabilities | Ψ- | , , , , , , | ず | , | | |
| | \$_ | 2,284,482 | \$_ | 1,950,547 | | |

GRAHAM COUNTY UTILITIES, INC. GAS DEPARTMENT

Schedule 2

STATEMENT OF INCOME AND ACCUMULATED MARGINS (DEFICITS) FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | Septe | 30, | Increase | | |
|--|----------------|-----------|-----------|-----------|-------------|----------------|
| | | 2005 | | 2004 | | (Decrease) |
| OPERATING REVENUES | _ | | _ | | | |
| Residential | \$ | 2,047,559 | \$ | 1,785,736 | \$ | 261,823 |
| Irrigation | | 13,332 | | 24,286 | | (10,954) |
| Commercial and Industrial | | 629,413 | | 513,134 | | 116,279 |
| Fuel Cost Overbilled | | 19,700 | | 22,230 | | (2,530) |
| Other Operating Revenues | | 300,362 | | 391,697 | | (91,335) |
| Total Operating Revenues | \$_ | 3,010,366 | \$_ | 2,737,083 | \$ | 273,283 |
| OPERATING EXPENSES | | | | | | |
| Purchased Gas | \$ | 1,846,966 | \$ | 1,629,487 | \$ | 217,479 |
| | Ψ | 229,205 | Ψ | 233,323 | Ψ . | (4,118) |
| Operations | | 182,330 | | 196,831 | | (14,501) |
| Maintenance | | 194,397 | | 204,843 | | (10,446) |
| Customer Accounts | | 261,449 | | 236,883 | | 24,566 |
| Administrative and General | | 106,226 | | 103,638 | | 2,588 |
| Depreciation and Amortization | | 33,002 | | 26,536 | | 2,366 6,466 |
| Other Interest | s ⁻ | 2,853,575 | \$ | 2,631,541 | \$ - | 222,034 |
| Total Operating Expenses | Ψ | 2,055,575 | Ψ_ | 2,031,341 | Ψ | 222,034 |
| OPERATING MARGINS - Before Fixed Charges | \$ | 156,791 | \$ | 105,542 | \$ | 51,249 |
| FIXED CHARGES Interest on Long-Term Debt | | 92,640 | | 84,185 | | 8,455 |
| OPERATING MARGINS - After Fixed Charges | \$ | 64,151 | \$ | 21,357 | \$ | 42,794 |
| Capital Credits | _ | 7,453 | _ | 6,581 | | 872 |
| NET OPERATING MARGINS | \$ | 71,604 | \$ | 27,938 | \$ | 43,666 |
| NONOPERATING MARGINS Interest | _ | 8,327 | · . | 3,094 | | 5,233 |
| NET MARGINS | \$ | 79,931 | \$ | 31,032 | \$ | 48,899 |
| ACCUMULATED DEFICITS - BEGINNING OF YEAR | _ | (112,194) | _ | (143,226) | | |
| ACCUMULATED DEFICITS - END OF YEAR | \$_ | (32,263) | \$_ | (112,194) | | |

GRAHAM COUNTY UTILITIES, INC. GAS DEPARTMENT

Schedule 3

STATEMENT OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | September 30, | | 30, |
|---|----------------|---------------|------------|-----------|
| | . · · <u>-</u> | 2005 | | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES | _ | | | |
| Net Margins | \$ | 79,931 | \$ | 31,032 |
| Adjustments to Reconcile Net Margins to Net Cash | | | | |
| Provided by (Used in) Operating Activities | | | | |
| Depreciation and Amortization | | 106,226 | | 103,638 |
| Capital Credits - Noncash | | (7,453) | | (6,581) |
| Deferred Charges | | 2,273 | | 6,049 |
| Overbilled Fuel Cost - Net | | (308,570) | | (389,707) |
| Accounts Receivable | | (52,066) | | (428) |
| Inventories and Other Current Assets | | (5,889) | | 4,652 |
| Payables and Accrued Expenses | | (218) | | 21,946 |
| Net Payments to - Water Department | | 116,017 | | 23,190 |
| Net Payments to - Graham County Eelectric Cooperative | | 316,933 | | (15,304) |
| Net Cash Provided by (Used in) Operating Activities | \$_ | 247,184 | \$_ | (221,513) |
| | | | _ | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| Additions to Gas Utility Plant | \$ | (158,515) | \$ | (103,611) |
| Investments in Associated Organizations | | 10,989 | | 11,839 |
| Net Cash Used in Investing Activities | \$ | (147,526) | \$_ | (91,772) |
| · · | | | _ | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | |
| Advances from CFC | \$ | | \$ | 400,000 |
| Payments on Long-Term Debt - CFC | | (68,878) | | (58,459) |
| Payments on Long-Term Debt - Graham County Electric Cooperative | | (31,065) | | (28,856) |
| Memberships | | 285 | | 600 |
| Net Cash Provided by (Used in) Financing Activities | \$_ | (99,658) | \$ | 313,285 |
| | | | | |
| INCREASE (DECREASE) IN CASH | \$ | 0 | \$ | 0 |
| | | • | | |
| CASH - BEGINNING OF YEAR | _ | 0 | _ | 0 |
| CASH - END OF YEAR | \$ | 0 | \$ | 0 |
| CASH-END OF TEAK | Ψ= | | Ψ== | |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | | |
| Paid during the year for: | | | | |
| Interest on Long-Term Debt | \$ | 92,640 | \$ | 99,830 |
| Federal Income Tax | | 02,070 | ~ <u>~</u> | 20,000 |
| receial income tax | Ψ | U | Ψ_ | U |

GRAHAM COUNTY UTILITIES, INC. WATER DEPARTMENT

Schedule 4

BALANCE SHEET SEPTEMBER 30, 2005 AND 2004

ASSETS

| | | Septe | ember | · 30. |
|--|----------------------|---|-------------------------|---|
| | | 2005 | | 2004 |
| UTILITY PLANT AT COST | _ | | _ | |
| Water Plant in Service | \$ | 1,975,356 | \$ | 1,938,655 |
| Construction Work in Progress | • | 81,322 | | 1,651 |
| Plant Acquisition Adjustment | | 610,168 | | 610,168 |
| Transfer to quinting to the same to | s — | 2,666,846 | s | 2,550,474 |
| Less: Accumulated Provision for Depreciation | • | _,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,, | • | ,, |
| and Amortization | | 1,455,002 | | 1,350,502 |
| - Wild Full Of Cast of | <u>s</u> – | 1,211,844 | ·s - | 1,199,972 |
| | * - | 1,211,011 | Υ- | .,, |
| OTHER PROPERTY AND INVESTMENTS AT COST OR | | | | |
| STATED VALUE | | | | |
| Investments in Associated Organizations | \$ | 123,333 | \$ | 127,200 |
| Investments in Associated Organizations | Ψ | 120,000 | Ψ_ | 121,200 |
| CURRENT ASSETS | | | | |
| Cash - General | \$ | 19,124 | \$ | 18,908 |
| Accounts Receivable - Customers (Less allowance for | Ψ | 15,124 | Ψ | 10,300 |
| | | 22,268 | | 11,601 |
| uncollectibles of \$9,530 in 2005 and \$7,853 in 2004) | | * | | 30,473 |
| Accounts Receivable - Gas Department | | 146,490 | | |
| Accounts Receivable - Graham County Electric Cooperative | | 44.075 | | 176,188 |
| Materials and Supplies | | 44,275 | | 28,094 |
| Other Current and Accrued Assets | | 7,790 | | 9,561 |
| Total Current Assets | \$ _ | 239,947 | \$_ | 274,825 |
| | • | 07.450 | • | 00.504 |
| DEFERRED CHARGES | \$_ | 27,152 | \$_ | 30,581 |
| | | | | |
| | • | 4 000 070 | • | 4 000 570 |
| | \$_ | 1,602,276 | \$_ | 1,632,578 |
| | \$_ | 1,602,276 | \$_ | 1,632,578 |
| EQUITIES AND LIABILITIES | \$_ | 1,602,276 | \$_ | 1,632,578 |
| EQUITIES AND LIABILITIES | \$ _ | 1,602,276 | \$_ | 1,632,578 |
| EQUITIES AND LIABILITIES EQUITY | | | | |
| EQUITY Memberships | \$ * | 2,500 | \$ _ | 2,500 |
| EQUITY | | 2,500 157,076 | \$ | 2,500 110,171 |
| EQUITY Memberships | | 2,500 | | 2,500 |
| EQUITY Memberships | \$ | 2,500 157,076 | \$ | 2,500 110,171 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT | \$ | 2,500 157,076 | \$ | 2,500 110,171 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities | \$ | 2,500 157,076 | \$ | 2,500 110,171 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT | \$ \$ | 2,500 157,076 159,576 | \$ \$_ | 2,500 110,171 112,671 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities | \$ \$ | 2,500 157,076 159,576 718,319 | \$ \$_ | 2,500 110,171 112,671 768,722 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities | \$ \$ | 2,500 157,076 159,576 718,319 89,834 | \$ \$_ | 2,500 110,171 112,671 768,722 111,834 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities | \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 | \$ \$_ | 2,500 110,171 112,671 768,722 111,834 509,939 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities | \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 | \$ \$_ | 2,500 110,171 112,671 768,722 111,834 509,939 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 | \$ \$_ | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt | \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 18,686 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes Customers' Deposits and Prepayments | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 8,680 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes Customers' Deposits and Prepayments Accrued Payroll | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 8,680 609 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 18,686 7,835 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes Customers' Deposits and Prepayments Accrued Payroll Accrued Interest | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 8,680 609 2,328 | \$ \$_ \$_ \$_ | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 18,686 7,835 2,109 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes Customers' Deposits and Prepayments Accrued Payroll | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 8,680 609 | \$ \$ \$ - | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 18,686 7,835 |
| EQUITY Memberships Accumulated Margins LONG-TERM DEBT CFC Mortgage Notes Less Current Maturities AEPCO Notes Payable Less Current Maturities USDA Rural Development Notes Less Current Maturities CURRENT LIABILITIES Current Maturities of Long-Term Debt Accounts Payable - Other Accounts Payable - Related Parties Accrued Taxes Customers' Deposits and Prepayments Accrued Payroll Accrued Interest | \$ \$ \$ \$ | 2,500 157,076 159,576 718,319 89,834 501,629 1,309,782 79,600 21,057 35 20,609 8,680 609 2,328 | \$ \$_ \$_ \$_ | 2,500 110,171 112,671 768,722 111,834 509,939 1,390,495 81,033 19,749 18,686 7,835 2,109 |

GRAHAM COUNTY UTILITIES, INC. WATER DEPARTMENT

Schedule 5

STATEMENT OF INCOME AND ACCUMULATED MARGINS FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | Septe | mber | 30. | | Increase |
|-------------------------------------|-----------|---------|--------------|---------|----|-----------|
| | - | 2005 | | 2004 | (| Decrease) |
| OPERATING REVENUES | | | | | | |
| Residential | \$ | 484,743 | \$ | 474,991 | \$ | 9,752 |
| Commercial and Industrial | | 48,192 | | 50,980 | | (2,788) |
| Sales for Resale | | 29,907 | | 29,053 | | 854 |
| Other Operating Revenues | | 2,160 | | 2,130 | | 30 |
| Total Operating Revenues | \$ | 565,002 | \$ | 557,154 | \$ | 7,848 |
| OPERATING EXPENSES | | | | | | |
| Purchased Power - Pumping | \$ | 24,647 | \$ | 33,811 | \$ | (9,164) |
| Operations | | 65,301 | | 66,060 | | (759) |
| Maintenance | | 131,954 | | 151,936 | | (19,982) |
| Customer Accounts | | 41,146 | | 42,753 | | (1,607) |
| Administrative and General | | 85,333 | | 81,939 | | 3,394 |
| Depreciation and Amortization | | 104,500 | | 103,856 | | 644 |
| Other Interest | | 3,887 | | 3,902 | | (15) |
| Total Operating Expenses | \$ | 456,768 | \$ | 484,257 | \$ | (27,489) |
| OPERATING MARGINS - Before | | | | | | |
| Fixed Charges | \$ | 108,234 | \$ | 72,897 | \$ | 35,337 |
| FIXED CHARGES | | | | | | |
| Interest on Long-Term Debt | | 77,240 | · <u>-</u> _ | 77,506 | | (266) |
| OPERATING MARGINS (DEFICIT) - After | | | | | | |
| Fixed Charges | \$ | 30,994 | \$ | (4,609) | \$ | 35,603 |
| Capital Credits | | 7,387 | | 5,836 | | 1,551 |
| Capital Credits | | 1,001 | _ | 0,000 | _ | 1,001 |
| NET OPERATING MARGINS (DEFICIT) | \$ | 38,381 | \$ | 1,227 | \$ | 37,154 |
| NONOPERATING MARGINS | | | | | | |
| Interest | _ | 8,524 | | 4,100 | | 4,424 |
| NET MARGINS | \$ | 46,905 | \$ | 5,327 | \$ | 41,578 |
| ACCUMULATED MARGINS - BEGINNING | | | | | | |
| OF YEAR | | 110,171 | | 104,844 | | |
| | | 7 | _ | | | |
| ACCUMULATED MARGINS - END OF YEAR | \$ | 157,076 | \$ | 110,171 | | |

GRAHAM COUNTY UTILITIES, INC. WATER DEPARTMENT

Schedule 6

STATEMENT OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2005 AND 2004

| | | September 30, | | · 30, |
|---|---------------|---------------|---------------|----------|
| | _ | 2005 | | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | |
| Net Margins | \$ | 46,905 | \$ | 5,327 |
| Adjustments to Reconcile Net Margins to Net Cash | | | | |
| Provided by Operating Activities | | | | |
| Depreciation and Amortization | | 104,500 | | 103,857 |
| Capital Credits - Noncash | | (7,387) | | (5,836) |
| Deferred Charges | | 3,429 | | 4,190 |
| Accounts Receivable | | (10,667) | | 2,630 |
| Inventories and Other Current Assets | | (14,410) | | 7,842 |
| Payables and Accrued Expenses | | 4,904 | | 5,627 |
| Net Advances from/(to) - Gas Department | | (116,017) | | (23,190) |
| Net Payments from/(to) - Graham County Electric Cooperative | | 176,233 | | (9,476) |
| Net Cash Provided by Operating Activities | \$_ | 187,490 | \$ | 90,971 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| Additions to Plant | \$ | (116,372) | \$ | (27,564) |
| Investments in Associated Organizations | Ψ | 11,237 | Ψ | 11,254 |
| Net Cash Used in Investing Activities | \$ - | (105,135) | s | (16,310) |
| | · | (100) | ` | <u> </u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | |
| Payments on Note Payable to AEPCO | \$ | (23,833) | \$ | (20,168) |
| Payments on Long-Term Debt to CFC | | (50,402) | | (46,789) |
| Payments on Long-Term Debt to USDA | | (7,904) | . — | (7,549) |
| Net Cash Used in Financing Activities | \$ | (82,139) | \$ _ | (74,506) |
| INCREASE IN CASH | \$ | 216 | \$ | 155 |
| CASH - BEGINNING OF YEAR | | 18,908 | | 18,753 |
| CASH - END OF YEAR | \$_ | 19,124 | \$ | 18,908 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | | |
| | | | | |
| Paid during the year for: | | | | |
| Interest on Long-Term Debt | \$_ | 77,240 | \$_ | 77,508 |
| Federal Income Tax | \$ | 0 | \$ | 0 |
| | | | - | |

COMPLIANCE AND INTERNAL CONTROL SECTION

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

FAX: (806) 747-3815

1623 10TH STREET

LUBBOCK, TEXAS 79401-2685

LETTER TO BOARD OF DIRECTORS REGARDING POLICIES CONCERNING AUDITS OF CFC BORROWERS

Board of Directors Graham County Utilities, Inc. Pima, Arizona

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Graham County Utilities, Inc., for the year ended September 30, 2005, and have issued our report thereon dated October 27, 2005.

In connection with our audits nothing came to our attention that caused us to believe that the cooperative failed to comply with the terms of Article V of the National Rural Utilities Cooperative Finance Corporation Loan Agreement insofar as they relate to accounting matters. However, our audits were not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of the Boards of Directors and management of Graham County Utilities, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Silbert & Mars LLP

Certified Public Accountants

October 27, 2005

Bolinger, Segars, Gilbert & Moss, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

FAX: (806) 747-3815

1623 10TH STREET

LUBBOCK, TEXAS 79401-2685

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors Graham County Utilities, Inc. Pima, Arizona

We have audited the financial statements of Graham County Utilities, Inc. as of and for the year ended September 30, 2004, and have issued our report thereon dated October 27, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Graham County Utilities, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

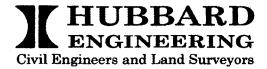
As part of obtaining reasonable assurance about whether Graham County Utilities, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of the Boards of Directors and management of Graham County Utilities, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Silbert & Mars LLP

Certified Public Accountants

October 27, 2005



625 N. Gilbert Rd., Suite 106 Gilbert, Arizona 85234 Tele. (480) 892-3313 FAX (480) 892-7051

July 25, 2006

RE: Graham County Utility – Pima Water Development Summary

In 2005, studies were completed by SWCA Environmental Consultants for Biological and Archaeological Surveys. No significant findings were discovered that impact this project. One possible area of interest was identified, but the Utility will adjust the project to not impact this area.

In August of 2005, Fluid Solutions completed a Water Resources Study for Graham County Utilities. This is a comprehensive report that addresses existing facilities, provides input on future needs and makes recommendations for improvements to be made. This document also specifies the location of additional wells, pipelines and tank location/specifications. This report functions as the Engineer's Design Report.

One pilot well was drilled as recommended in the Study to verify that conditions for "good" water could be met. The pilot well was a success and it was determined that it should be put into production.

Based on the recommendations of the Water Resources Study, bid documents were prepared by Fluid Solutions in February of 2006 for the drilling of multiple water wells. Bid opening was March 6, 2006. No bidders responded to the bid.

In March 2006, Hubbard Engineering assisted the Utility in developing a strategy to select a drilling company(s) and proceed with the project. The need for a new water source was becoming desperate at this point. A process was developed where several prominent well drilling companies would be interviewed to determine what their individual qualifications and approach would be to this project. A list of topics was prepared for each interview to insure that all drillers were asked the same questions. Representatives from Hubbard and the Utility were present at all interviews. Large national firms and local firms were interviewed to provide a good cross section of qualifications. A copy of the interview form is attached. Based on the results of the interviews in March/April of 2006, two companies were selected based on their knowledge, experience and ability to perform. The results of the interviews were then reviewed with the Utility Board of Directors for concurrence and notice to proceed. Individual bids were then received from each company to insure that the cost would be within the guidelines of the Water Resources Study which the project budgets were based upon. One large firm, (Weber Group), and one local firm (Cueto

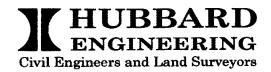
Drilling) was selected. Each provided a proposal within budget and work was commenced in May of 2006. Wells are being drilled in the locations as specified in the Water Resources Study.

During May/June of 2006, design and plans were submitted to ADEQ for the well and waterline associated with the pilot well. Approval to Construct was received by ADEQ, construction was completed by the Utility and the Certificate of Completion is being finalized with ADEQ at this time.

As noted above, two wells are being drilled at this time. Upon completion of construction and testing, pipeline designs will be prepared to connect these wells into the current distribution system.

Design for a new water tank is being prepared at this time as noted in the Water Resources Study. This design will be based upon typical design requirements and will be designed such to work in conjunction with the existing tanks and to be the most cost affective design (height vs. width). Brown Tank Company will be used as a "no cost" consultant to assist with the tank design. Upon ADEQ approval of the plans, bidding will take place for the tank. The bid will be an advertised, open public bid. Specific invitations to bid will be sent to various suppliers that have provided product to the Utility in the past.

This represents the work that has been completed or is currently underway for this project as of July 25, 2006.



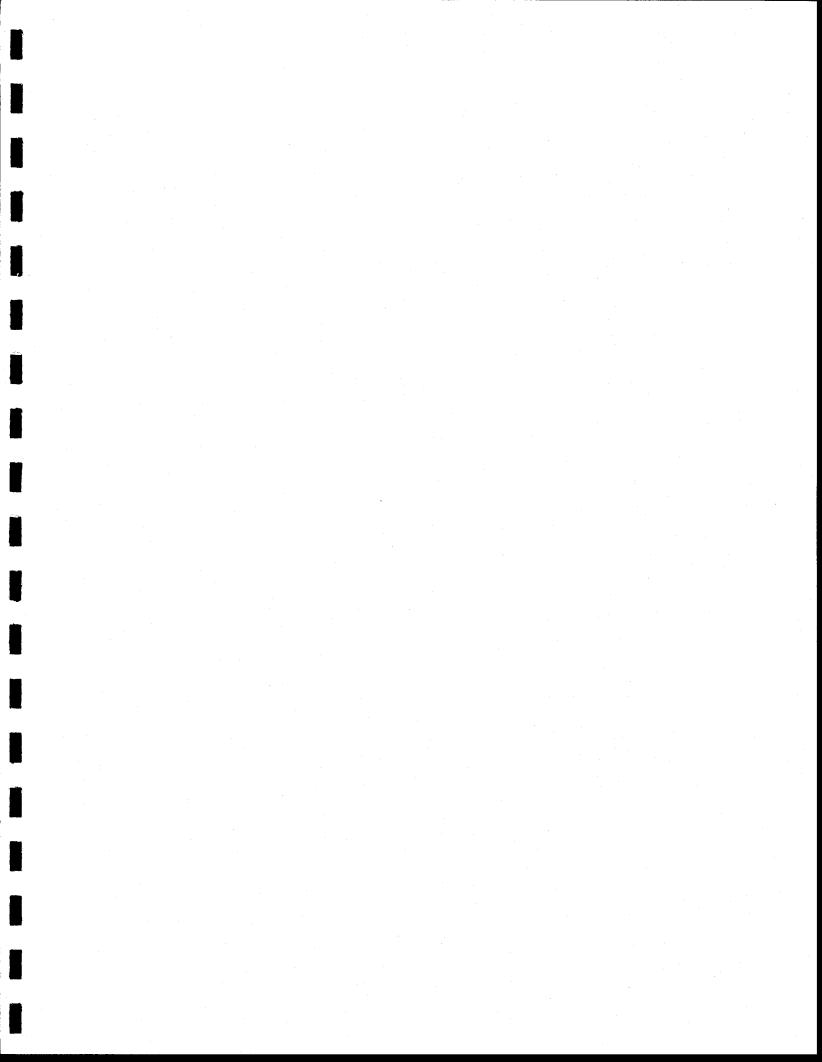
625 N. Gilbert Rd., Suite 106 Gilbert, Arizona 85234 Tele. (480) 892-3313 FAX (480) 892-7051

Douglas K. Hubbard dhubbard@hubbardengineering.com

| DRILLER: | | |
|----------|--|--|
| DATE: | | |

- A. GCU provides brief overview of project
 - Studies completed to date
 - Work completed to date
 - Work yet to be completed
 - Schedule
- B. Driller gives general overview of company
- C. Driller gives specific examples of experience
 - Rotary drilling
 - Cable tool drilling
 - Acquiring permits (drilling, testing, final)
 - Depth specific drilling and water testing
 - Perforation size input
- D. Recommended Approach
 - How would driller recommend we approach this project
 - Hole diameter
 - Casing diameter
 - Open hole or drill and case
 - Schedule that could be achieved
- E. Terms and Conditions
 - Mobilization and Remobilization during drilling and testing
 - Billing and Payment
 - Equipment failure and/or unforeseen conditions
 - Pricing structure for 1 or up to 6 wells
 - Permitting
 - Reimbursements
 - Soil Sample specimens
 - Water sample responsibility

Cost per foot base on projected 700 foot well



Form RD 1942-46 (Rev. 6-98)

UNITED STATES DEPARTMENT OF AGRICULTURE RURAL DEVELOPMENT FARM SERVICE AGENCY

FORM APPROVED OMB NO. 0575-0015

LETTER OF INTENT TO MEET CONDITIONS

TO: United States Department of Agriculture

Lq LAL DEVELOPAENT

(Name of USDA Agency)

(USDA Agency Office Address)

We have reviewed and understand the conditions set forth in your letter dated 6/20/0 It is our intent to meet all of them not later than 12/21/56.

GARHAM Coanty UTILITIES 2NC.

(Name of Association)

BY

TENALD L. Kenyton Secretary

(Title)

According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0015. The time required to complete this information collection is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data. needed, and completing and reviewing the collection of information.

Form RD 1942-8 (Rev. 2-98)

Position 5 UNITED STATES DEPARTMENT OF AGRICULTURE RURAL DEVELOPMENT

FORM APPROVED OMB NO. 0575-0015

RESOLUTION OF MEMBERS OR STOCKHOLDERS

| GRAHAM COUNTY UTILITIES, INC. |
|---|
| (Name of Association) |
| CRAHAM COUNTY UTILITIES INC. (Name of Association) P.O. DRAWER B PIMA AZ 85543 (Address, including Zip/Code) |
| |
| RESOLVED, that the Governing Board of this Association be and it hereby is authorized and empowered to take all action necessary or appropriate — |
| To obtain for and on behalf of the Association through the United States Department of Agriculture (USDA) or any other Governmental agency: |
| (a) A loan in a sum not to exceed \$ / / 00, 600; (b) A grant in a sum not to exceed \$ / 9 6 / 20; to be advanced by the lender or grantor in one or more advances at such time or times as may be agreed upon. |
| (b) A grant in a sum not to exceed \$ 969 620; |
| to be advanced by the lender or grantor in one or more advances at such time or times as may be agreed upon. |
| 2. In case of a loan or grant or both — (a) For the execution of such application or applications (including exhibits, amendments and/or supplements thereto) as may be required: (b) For the execution and delivery to the lender or grantor of all such written instruments as may be required in regard to or as evidence of such loan or grant; and (c) In its judgment to carry out the terms of this resolution. |
| 3. And in case of a loan — (a) To obligate this Association for the repayment of the loan at such rates of interest and on such other terms and conditions as the Governing Board shall deem proper; (b) To pledge, hypothecate, mortgage, convey, or assign property of this Association of any kind and in any amount now owned or hereafter acquired, as security for any or all obligations (past, present and/or future) of this Association to such lender; and (c) From time to time to pay, extend, or renew any such obligations. |
| CERTIFICATION |
| I, the undersigned, as SECRETARY of the above named Association, hereby (Secretary) (Acting Secretary) |
| certify that said Association on the 3R day of Aug 6457, 2006, had 9 |
| (Number) |
| certify that said Association on the 3R day of Ay Gy 57, 2006, had 9 (Number) D RECTOR 5 RESENT; that 5 of these (members) (stockholders) or (shares of voting stock outstanding) |
| constituted a quorum; that said members or stockholders or shares of voting stock were present at a meeting |
| of the members or stockholders duly called and held on the 3RD day of August, 2006 that the foregoing resolution was adopted at such meeting by the affirmative vote of 9 said members |
| that the foregoing resolution was adopted at such meeting by the affirmative vote of said members |
| or stockholders or shares of voting stock; and that said resolution has not been rescinded or amended in any way. |
| Dated this day 3 No of Aug 77, 200.6 |
| Secretary of GRAHAM COUNTY MTHERE |

According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0015. The time required to complete this information collection is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

Water Resources Study for Graham County Utilities

Prepared for:
Graham County Utilities, Inc.
P.O. Drawer B
Pima, Arizona 85543

Prepared by:

Fluid Selutions

1121 E. Missouri, Suite 100
Phoenix, Arizona 85014



August 9, 2005



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| | |





1.0 Executive Summary

1.1 Background

Graham County Utilities serves domestic water supplies to approximately 1000 customers in the area of Pima just west of Safford in Graham County Arizona. The resource consists of 13 wells with 10 wells having a capacity of approximately 383-gpm. Primary issues with these wells focus on the impacts of the current drought and the pending Environmental Protection Agency (EPA) arsenic standards. Figure 1-1 provides a general location of the Utility Well Field.

Currently, the Utility is experiencing difficulty in maintaining the water supplies during the warmer months of the year. This is mostly likely brought on by long-term drought conditions causing a reduction in groundwater supply. The reduction is accentuated by the shallow depth and close spacing of supply wells, production from thin, shallow aquifers, and low storage and transmissive properties of the shallow aquifers. An additional water resource is required to mitigate this condition resulting in a reliable supply for existing water users in the community. This additional groundwater resource must be in deeper, thicker aquifers (sands), and in areas further away from exising wells to help mitigate the current supply problems.

The Utility is also faced with a water quality issue because the aggregate arsenic levels from the existing well field exceeds the new EPA standard of 10 μ g/l. This standard will take effect January 23, 2006. The impact of this standard requires all suppliers of potable water that exceed this arsenic level to correct this deficiency. The choices for the Utility include treatment through chemical means or blending.

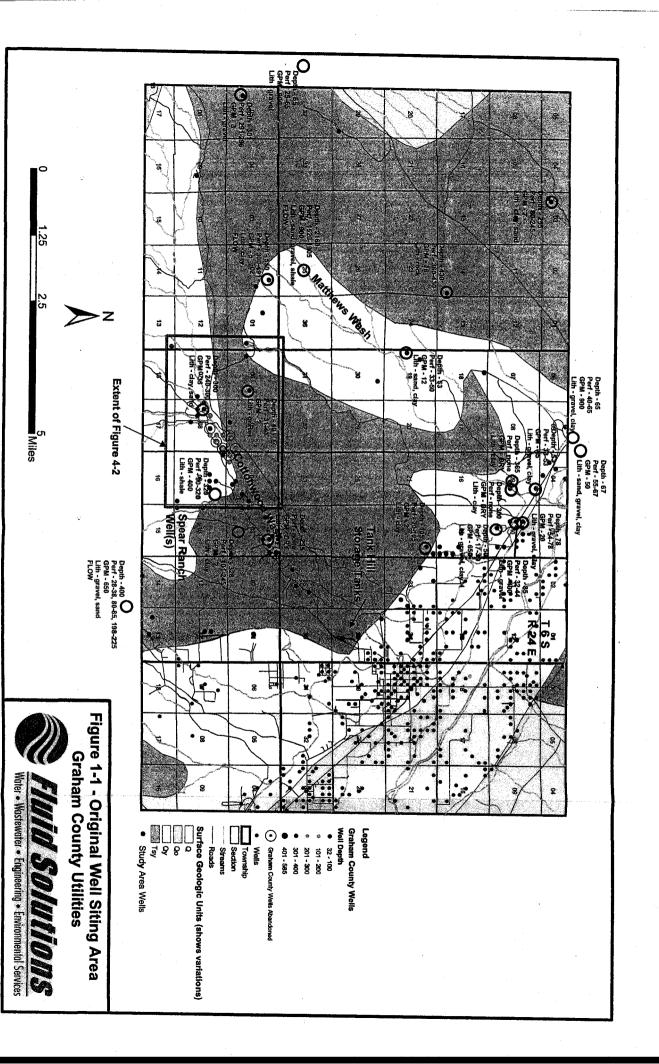
Graham County Utilities obtained a Water Infrastructure Authority (WIFA) grant for \$35,000 and a loan for \$77,999 to perform a study to analyze the conditions and alternative solutions. This report responds to that effort and provides the background information required to request additional funding to effect the solution for the Utility.

1.2 Well Siting Study and Pilot Well Results

The well siting study focused on location of a well site that appeared favorable for water quantity and quality. Based on review of the available hydrogeologic data and newly gathered water quality data, a well site was selected in the southern half of Section 8, Township 7 South, Range 24 East. This well was drilled to approximately 700-feet deep using a dual rotary drilling technology.

The drilling method is similar to the cable tool methods in that the result is typically very plumb, water quality samples can be obtained during drilling, no drilling mud is used, and casing can be advanced while drilling. This





method has been successfully used by Fluid Solutions throughout Arizona in identifying potable water in aquifers exhibiting non-potable characteristics. It allows for selective screening of a well in an attempt to isolate acceptable water quality from unacceptable quality. The approach has proven to provide depth-specific water quality results that closely approximate completed well production testing. Similar result could be obtained from a cable tool well, but the dual rotary technique is faster, may offer more options for well completion, and may produce more reliable depth-specific data.

The pilot well drilled was cased with 6-inch pipe to 700-ft. Depth specific sampling indicated that the best water quality was attainable between 390 and 600-ft. Arsenic levels in this zone was found to be less than 2 μ g/l. Pump testing yielded a pump rate of 87-gpm. Due to the excellent results found in the pilot well, the current plan is to equip it and use it as a formal system well.

1.3 Recommendations for Future Wells

Six primary well sites have been identified in Figure 1-2. These locations are based on the data collected describing the geology and hydrogeology of the area in an attempt to secure high quality water of suitable volumes.

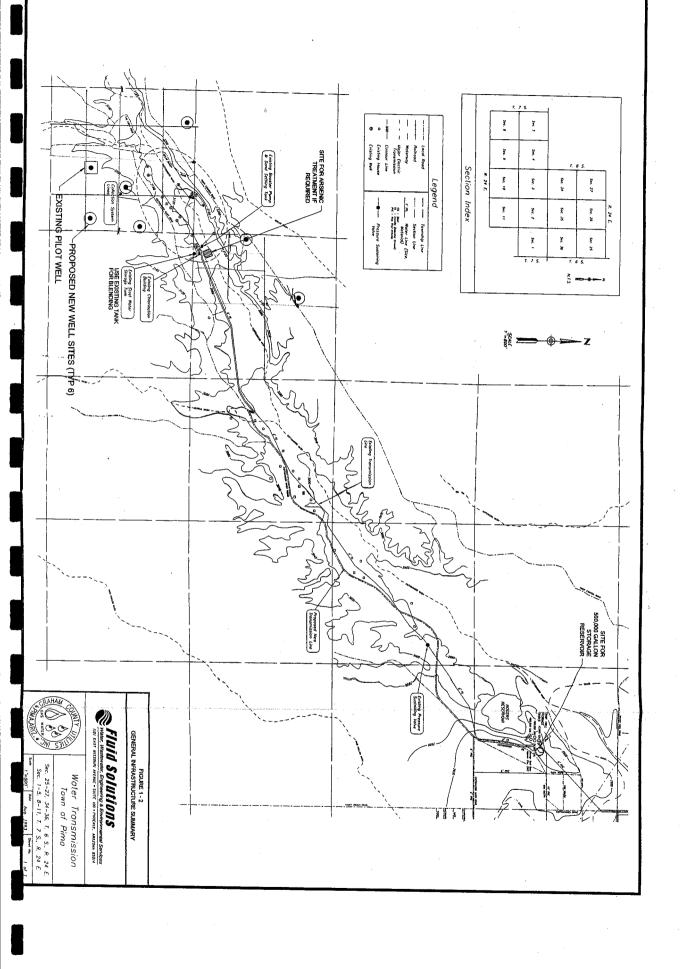
It is recommended that these wells target the 700-ft to 750-ft depth. The objectives are as follows:

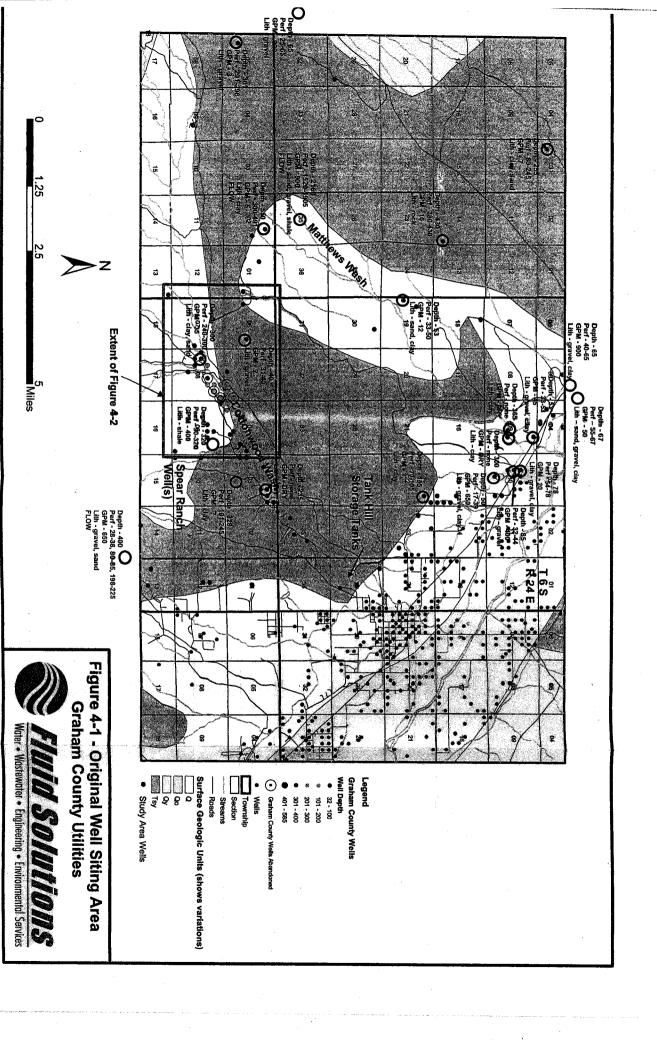
- Provide protection from the drought conditions and lowering of static groundwater;
- Provide higher producing wells that is believed possible in the thicker sand aquifers found during the pilot well; and,
- Provide some protection against arsenic located in the upper production zones along Cottonwood Wash.

Based on the data collected during the pilot well these wells could produce from 100-gpm to 300-gpm from the aquifer. For the purposes of this report, we are assuming that the average aquifer yield with consideration for safe reliable equipment installations, each well will yield approximately 100 to 150-gpm. If quantities are greater and quality is maintained, fewer wells may be required to meet the objectives of the Utility for water quality and quantity.

A 10-inch well casing can accommodate quantities of up to approximately 700-gpm using a 3,500-rpm submersible pump, and approximately up to 500-gpm using a 1,700-rpm submersible pump. This will allow the Utility to maintain flexibility in equipping a well based on actual test results while not spending money on a well that is larger than is likely to be required.







The cost differential between an 8 and 10-inch casing is small while the differential between a 10 and 12-inch well is significant. An installation using lower rpm pumps will last longer than higher rpm pumps but at a higher initial capital and operations cost. Therefore, we recommend maximizing the size of the lower cost wells by using a 10-inch casing. This will allow a well that may greatly exceed expectations to be developed while still being cost effective for the Utility.

The data collected indicates that as we move away from Cottonwood Wash, the arsenic levels decline. It is unknown if there is a natural arsenic deposit in the formation that the existing supply wells are producing from or if natural arsenic is being transported laterally and/or vertically in the groundwater to the existing supply wells. Because of the noted arsenic phenomenon all of the recommended sites for new wells are outside of the current wash well field but still within the Utility lands.

1.4 Recommendations

Fluid Solutions recommends that the Utility pursue improvements in three phases on an as needed basis. Funding for each phase shall be independent of each other. The individual phases shall be divided as wells, storage, and treatment. Well improvements shall be the first phase. Additional wells will minimize the need for additional storage today; therefore, storage shall be a separate phase to be pursued on an as needed basis. Treatment should only be pursued if required and that determination cannot be made until the new wells are constructed and tested.

1.4.1 Phase I Improvements

At this time the wells are the highest priority improvement required by the Utility. Addition of wells will likely improve the water quality to meet SDW standards assuming new wells meet the 2006 arsenic requirements. The pilot well drilled was capable of producing 87-gpm with an arsenic level below 2.0 μ g/l. It is reasonable to assume that the new wells will produce in the 80-gpm range. However, it is not safe to assume that the arsenic levels will be maintained at a low enough level to permit blending with the existing wells to meet the 2006 arsenic standard. It is also not safe to assume that the existing wells will not continue to be impacted by the current trend in declining water levels.

Because of the unknowns as it relates to water quality of new wells and sustainability of existing wells it is recommended that the Utility pursue drilling of six new wells. Assuming that each well produces 80-gpm, six wells will replace the existing non-compliant wells that are becoming less reliable and provide one redundant well to the system. We would also recommend that the pilot well drilled be equipped. Table 1-1 summarizes the budget for this phase.



Table 1-1
Phase One Estimated Budget Costs

| Component | Cost per Unit | Number | Phase Estimate |
|----------------|---------------|--------|----------------|
| Well | \$ 210,760 | 6, | \$1,264,560 |
| Equip Pilot | \$ 120,560 | 1 | \$ 120,560 |
| Total Estimate | | | \$1,385,120 |

This assumes that the 16-inch casing will be usable for a minimum of two wells prior to it becoming cost prohibitive. It also limits on-site observation to only a couple of days requiring Utility staff to monitor progress and collect required samples.

1.4.2 Phase II Improvements

Phase two may be either the storage or treatment depending upon the actual well water quality collected. This report assumes storage will be phase two with blending capable of meeting short term treatment needs. Table 1-2 summarizes the phase two costs.

Table 1-2
Phase Two, Estimated Budget Costs

| Component | Cost per Unit | Number | Phase Estimate |
|-------------------|---------------|--------|----------------|
| Storage Reservoir | \$ 566,500 | 1 | \$ 566,500 |

1.4.3 Phase III Improvements

Phase three is only required if the wells do not produce water quality sufficient to meet the 2006 arsenic standards either outright or through a blending plan. Table 1-3 summarizes the phase three costs.

Table 1-3
Phase Two, Estimated Budget Costs

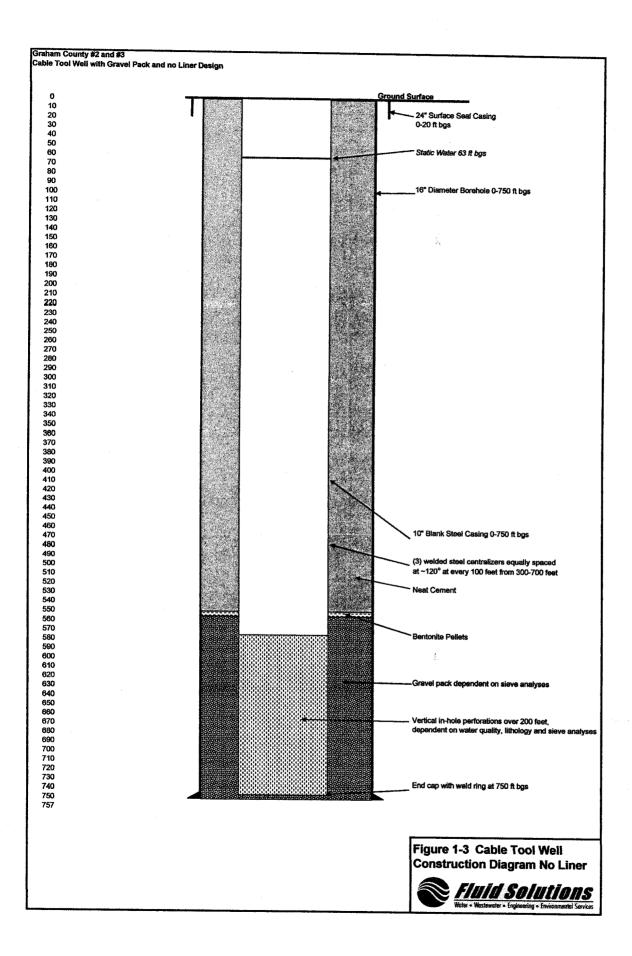
| Component | Cost per Unit | Number | Phase Estimate |
|-----------|---------------|--------|----------------|
| Treatment | \$ 411,400 | 1, | \$ 411,400 |

All costs in the phases shown above are based on August 2005 values. Based on current history, the cost of water utility infrastructure has risen steeply during the past several years. These increases have not trended with cost of living increases as they have in the past. Specific components such as steel have increased upwards towards 70% in a single year due to influences of the world



market and China. The Utility should be cognizant of this as the budget into the future.





2.0 Project Description

This project consisted of evaluation of well siting alternatives and preliminary exploration of groundwater conditions for the purpose of resolving water quantity and quality issues surrounding Graham County Utilities. This report summarizes the results of those investigations and recommends future improvements to meet the current needs of the Utility.

2.1 Purpose

This effort was divided into two phases. The first phase identified the most viable location for a potable production well of sufficient quantity and quality to meet the demands of the Utility. The specific objective of this phase was to locate a site for a pilot well that may be capable of providing water that could be blended with the existing water resources to meet the future arsenic regulations. A secondary objective will provide additional capacity to the Utility by development of a resource that could be blended to meet the arsenic requirements.

The second phase was to explore the subsurface conditions to determine the actual quality and potential quantity of the groundwater. This effort required development of a pilot well to obtain actual aquifer data.

This report summarizes those findings and recommends a plan for future action to meet Utility needs. The intent of this report is to provide a guide for proceeding with improvements as well as provide a document by which additional funding can be secured by the Utility. Funding sources may likely include Rural Development and WIFA in addition to any internal funding the Utility may be capable of developing.

2.2 Background

Graham County Utilities is faced with a water resource that does not meet the proposed water quality requirements for Arsenic as mandated by the United States Environmental Protection Agency (USEPA). This requirement goes into effect January 23, 2006 and requires that the Arsenic levels in all potable water systems be at or below 10-µg/l. The Utility has indicated that the first preference in meeting this requirement is to locate another water resource that could be blended with the existing resource to meet the new requirements. The second choice is formal treatment to meet this objective. The preference is blending because, in the long term, the cost to the consumer will likely be lower and the Utility is attempting to protect their consumers from hardship caused by this federally mandated regulation while meeting said regulations.

Additionally, the recent drought conditions that have plagued the Southwestern United States have impacted the ability of some of the existing wells to deliver water. This, in turn has left the Utility struggling to meet existing water demands within the system. Therefore, this



approach to meeting water quality standards will also stem the drought related problems faced by the Utility.

2.3 Scope of Work

This scope was performed in two phases. The first phase was an evaluation of the potential sites that may allow a well to be drilled having acceptable water quality and some level of reliable capacity. The second phase was exploratory. The intent was to determine if two criteria could be met. Was the water quality suitable to meet the 2006 arsenic standard and was the quantity sustainable?

2.3.1 Phase One

This consisted of gathering and reviewing all of the reasonably available information on the hydrogeology and existing wells within the study area. Data collected was compiled to assess lithologic and structural geologic relationships, aquifer characteristics, water quality information, and existing well production capabilities. Additionally, information was gathered from the Utility relating to the existing demands and existing well production.

This information was used to develop an opinion of potential locations to drill wells that may meet the water quality and quantity needs of Graham County Utilities. The sites that were determined to have the greatest potential of meeting these needs was further refined to select the apparent best site.

2.3.2 Phase Two

Phase two consisted of two parts. The first part was to drill an exploratory well to determine if the results of Phase One were correct. This consisted of drilling a pilot hole, performing depth specific water quality testing, and performing aquifer testing.

The second part consisted of identifying additional potential well sites. Additionally, an analysis of the infrastructure required to equip and connect the new wells to the system. This infrastructure includes wells, pumps, pipes, and storage facilities to allow the new resource to be incorporated with the existing resources and meet first meet 2006 water quality requirements while potentially adding capacity to the sytem.



3.0 Existing Water Resources

Graham County Utilities operates a water utility with wells, disinfection, transmission mains, and storage facilities that span across 15 sections of land located as shown in Figure 3-1. Table 3-1 summarizes the existing well capacities and arsenic concentrations.

Table 3-1
Existing Well Field Conditions

| Well | Equipped Capacity (gpm) | 2002 Arsenic (ug/l) | 2003 Arsenic (ug/l) |
|-------------------|-------------------------|------------------------|------------------------|
| Pima 1 | 22 | 13 | 6.2 |
| Pima 2 | 64 | 19 | 21 |
| Pima 3 | 37 | 17 | 16 |
| Pima 4 | 38 | 5.5 | 3 |
| Pima 5 | 40 | 17 | 11 |
| Pima 6 | 39 | 29 | 26 |
| Pima 7 | 54 | 37 | 33 |
| Cope 2 | 40 | 10 | 8.7 |
| Two Flow | 25 | 5.7 | 6.7 |
| Magnum 1 | 0 | 4.8 | |
| Herbert 1 | 0 | 66 | 50 |
| Herbert 2 | 0 | 10 | |
| Herbert 5 | 24 | 3.9 | 3 |
| Total Capacity | 383 | | |
| Aggregate Arsenic | | 17.72 | 15.69 |

Aggregate arsenic concentrations represent only the 10 wells that are in operation. It reflects the blended concentration assuming that all wells are operating to meet warm weather demands. The result is a violation of the pending 2006 SDW standard for arsenic. Therefore, either a blending scenario or a treatment scenario will be required to meet the new water quality standards.

Additionally, the existing wells are experiencing declining capacities due to the current groundwater declines, possibly due to drought conditions. This condition is impacting the ability of the Utility to meet demands during warm weather. The result is an unreliable water resource and a potential for the Utility to be forced into rationing or turning off supplies to some customers. Neither scenario is acceptable and new wells are required to mitigate the situation.



4.0 Pilot Well Results

4.1 Study Area

This study had a primary goal of finding groundwater resources that would solve the water supply and water quality issues. Fluid Solutions gathered all reasonably available information on the hydrogeology and existing wells within the study area for the purpose of evaluating groundwater capacity and water quality potential in the area. This information includes:

- published geologic and hydrogeologic reports (ADWR, USGS, ADEQ, Arizona Geological Survey),
- well logs,
- well construction information,
- water level histories,
- · well production records,
- interpreted aquifer characteristics,
- historic information from the Utility staff,
- well capacity information, and
- · water quality information.

Based on the preliminary evaluation of the above information of the area, the location of study area was expanded to include, not only the well field along Cottonwood Wash (N1/2 of Township 7 South, Range 24 East) and the Tank Hill Storage Tanks (Section 25, Township 6 South, Range 24 East), but also Mathews Wash to the west and the Spear Ranch Well area to the east as shown in Figure 4-1. This expansion of the study area was deemed necessary since there are possible subsurface geological conditions, i.e., salt deposits at depth (Rauzi, 2002) that may limit successful development of future well sites. In Figure 1-1 the regional groundwater flow direction is west-northwest along the Gila River; however, locally near the well field along Cottonwood Wash, groundwater flow is northward toward the river and, possibly, northeastward along the surface flow direction of the wash.

4.2 Gathered Water Quality Data

After review of the logs in this area, existing Utility well construction, well capacity, and water quality data provided by the Utility Fluid Solutions narrowed the search area down to the southern and western area of the initial study area and requested additional well information from the Utility as listed in our letter dated July 27, 2004. Data provided by the Utility is provided in Appendix 1. Upon review of this information, Fluid Solutions requested water quality data gathered from four wells in the vicinity of the existing Graham County Well Field. This data was provided to Fluid Solutions on November 2, 2004 and is shown in Table 4-1 and Appendix 2. After discussions with the Utility, it was decided that well locations at a great distance from the existing well field may not be possible because of



land availability and/or costs. A geologic cross section was constructed in the immediate vicinity of the well field in order to determine where the best proposed well location might be.

Table 4-1
Gathered Non-Utility Wells in Study Area
Water Quality Results

| | | Well | Name | |
|-----------------|--------|---------|--------|-------|
| Characteristic | Manner | Mattice | Allred | Spear |
| Arsenic (µg/l) | 3.7 | 35.0 | 5.1 | < 3.0 |
| Chromium (µg/l) | <10.0 | 17.0 | <10.0 | 16.0 |
| Fluoride (mg/l) | 1.4 | 1.63 | 2.48 | 0.63 |
| TDS (mg/l) | 156.0 | 1.68 | 224.0 | 125.0 |
| Nitrate (mg/l) | <1.0 | 1.75 | <1.0 | <1.0 |

4.3 Hydrogeologic Evaluation

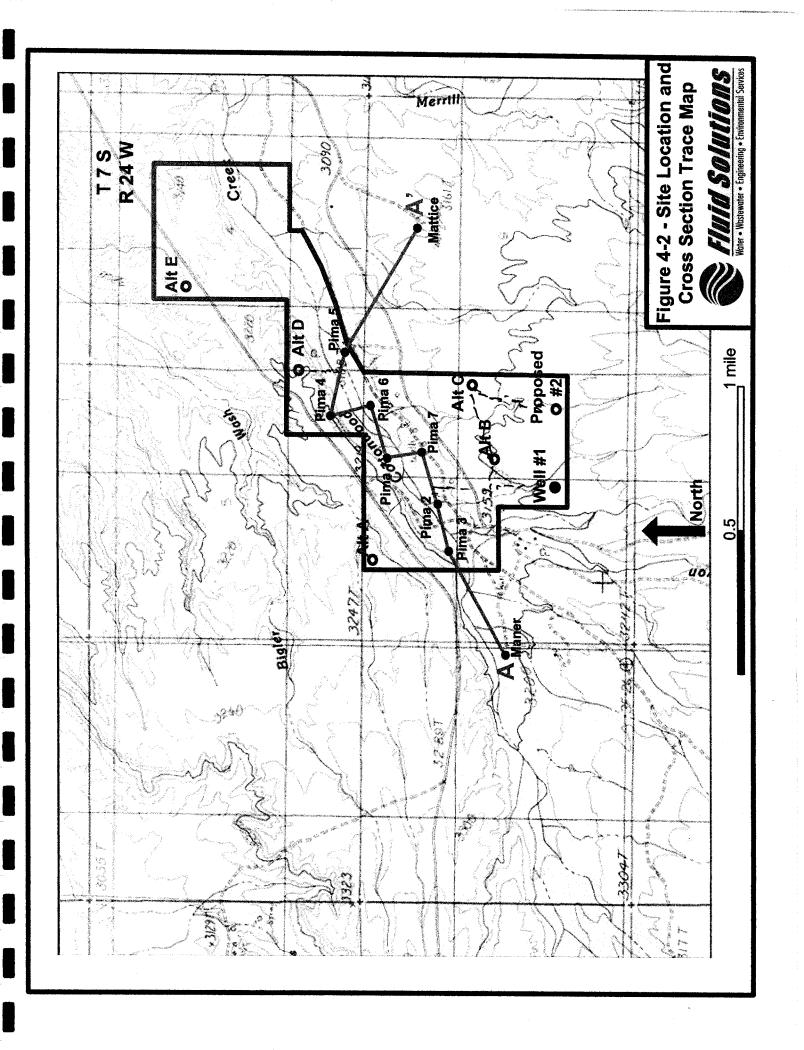
Fluid Solutions created a Cross Section through the existing well field as shown in Figures 4-2 and 4-3. The cross section was derived using ADWR well driller reports and water quality data collected by Graham County Utilities. Throughout the study area, subsurface lithology generally consists of interbedded clay, sandy clay and sand and gravels, with clays and sandy clays dominating. The sand layers appear more frequently and are generally thicker in the southwestern portion of the study area. Lithologic units are difficult to correlate from well to well with confidence because there is little consistency in driller reported geologic units from well to well as shown on Figure 4-3.

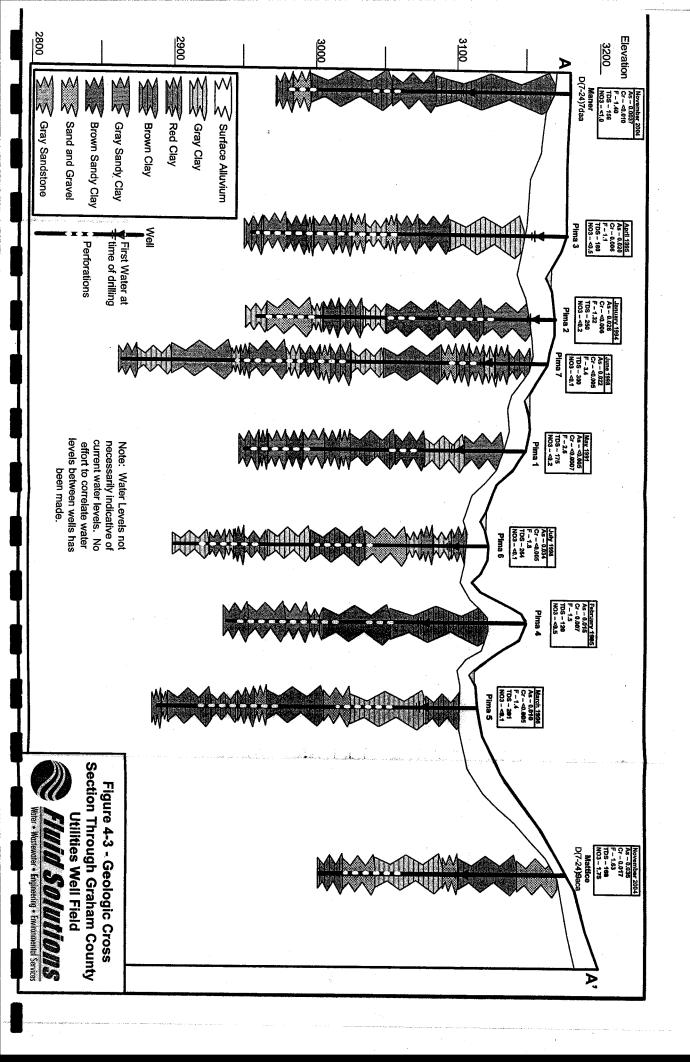
As shown in Table 4-1, arsenic collected from the Maner Well (D(7-24)7daa) was reported at 3.7 μ g/l, whereas wells located further to the northeast reported levels as high as 35 μ g/l in the Mattice well (D(7-24)9aca). This suggested that an optimum pilot well location would be in the southwest portion of the property.

Fluid Solutions recommended installing a well in the southwestern portion of the study area shown in Figure 4-2. This area appeared to offer the most favorable location to encounter thickest sand aquifers and best water quality.

Fluid Solutions recommended drilling a 700-foot, six-inch, cased pilot well using the Dual-Rotary method. This drilling technique offers the best opportunity for collection of depth-specific water quality samples while drilling. It is also a very cost effective method to produce from those aquifers identified, while still collecting needed data, at a cost within the budget of GCU. It is possible to obtain depth specific samples using other methods; however, none of them provide the reliability of the sample collected. In other words, other drilling methods increase the potential for water from differing depths to be blended







negatively impacting the depth specific results. Due to the speed of drilling and the method used to remove cuttings, Dual-Rotary methods can provide some of the most reliable depth specific sampling.

Reliable depth specific sampling allows the well completion to have the greatest potential of meeting needs of the Utility when aquifer characteristics yield varying water qualities and varying production rates. It allows the final well completion to move away from poor water quality in the way the well is completed. It also allows the well completion to be done in a manner that will potentially maximize the production while minimizing the potential of sanding. The end result is a method that provides unprecedented data that allows for potentially the best completion possible for the lowest cost when all variables are considered such as quantity, quality, and reliability.

4.4 Lithologic Data

Between ground surface and 380 feet below ground surface (bgs), the lithology in the pilot well is predominantly thinly bedded and interbedded clays, sandy clays, and clay-rich sands as shown in Figure 4-4. These depths are the same depths from which all current Utility wells produce. From 380 to 700 feet bgs (total depth), sands are thicker bedded and only two thin-bedded, clay-rich sands exist. Aquifers at depths below 380 feet had the most potential from a well capacity standpoint.

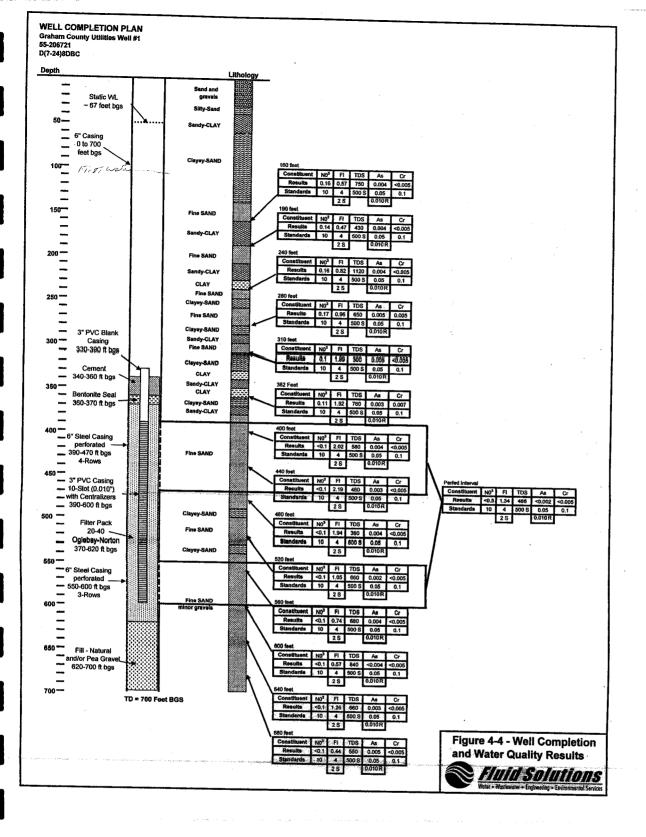
4.5 Water Quality

Fourteen depth-specific water quality samples were taken. Figure 4-4 summarizes this data and is supported by data contained Appendix 3. There was a slight suggestion that total dissolved solids increased with depth in the well. The surprising result was that all zones tested had very low arsenic values, as well as low nitrate levels. Fluoride had some elevated values (up to 2.19 mg/l), but still below the primary drinking water standard of 4.0 mg/l. Preliminary results of the New Source sampling are consistent with the depth-specific sampling. The new source data that is currently available is included in Appendix 4.

There are three working hypotheses to explain the low arsenic values in the pilot well. The first two hypotheses are that the high arsenic values in the wells along Cottonwood Wash are migrating into these wells either laterally or from below. The source of the arsenic lies at some distance from the wash.

The third hypothesis is that the arsenic is sourced from the clays that are interbedded with the sands in the upper 300 feet of the alluvial fill of Cottonwood Wash. The current supply wells for the Utility are screened in these units. Under this scenario groundwater is leaching the arsenic from the insitu clays.





4.6 Well Completion

Initially two zones were selected to perforate: 390-470 feet bgs and 560-660 feet bgs. As these zones were perforated and air lifted to the surface, sand production from the aquifer became an ever-increasing problem. The problem became so severe that perforating ceased with 390-470 and 550-600 feet bgs perforations. Subsidence was beginning to occur around casing at the surface, and there was a potential of loosing the well. There was also a concern with the rig subsiding next to the casing. Placing pea gravel outside the well stabilized the well.

Fluid Solutions decided to install a 3-inch PVC liner with a gravel pack since the well was thought to be capable of producing good quality water and at an acceptable rate. During drilling and perforating, approximately 200-gpm was being air lifted to the surface. The error potential of air lift pumping can be as much as plus or minus 60%, yielding a potential of 80 to 320-gpm during air lift activities (Manual for Centrifugal Compressor Engineering, Hoffman Air Systems). The efficiency of this type of pumping is directly related to the dispersion of air throughout the column of liquid. During drilling operations, this dispersion is typically not efficient because the diffusion system is a single orifice. Therefore, typical air lift error in a well is on the lower range of the production.

Three clay-rich zones were sampled to have a sieve analyses evaluated. These analyses assess the grain size distribution of clay-rich zones that may be screened and govern the finest filter pack and slot size to prevent production of the formation in a completed well. Additionally three other zones air-lifted to the surface were sampled and analyzed after the in-hole perforations were cut. These analyses suggested the 50 percentile passing was approximately 0.009 inches in diameter as shown in Figure 4-5. Based on this analysis, a 20-40 US Sieve Size Colorado Silica filter pack was selected and a 0.010 inch slotted, 3-inch diameter PVC screen was selected as a liner.

During installation of the filter pack and liner, the filter pack drained into the cavity into the aquifer through the in-hole perforations in the 6-inch steel casing. This problem was resolved by mixing pea gravel with the original filter pack to stabilize the loss into the aquifer. The final well construction is shown in Figure 4-4. During the liner installation air-lift development was conducted. Sand production problem was resolved after sealing the liner.

4.7 Aquifer Test Results

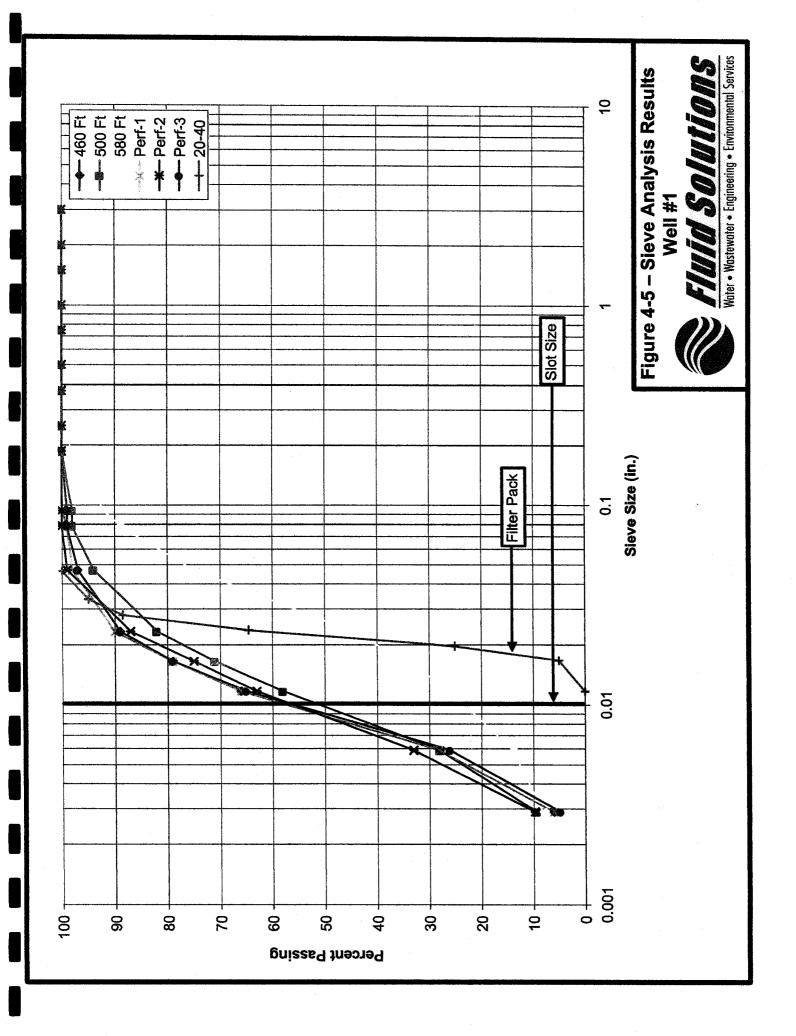
A pump test was conducted on this well. The approach was to conduct pump-test development with a step-up in rate, followed by a constant rate test. The maximum test rate was 87 gpm as shown in Figure 4-6. Static water level was 63 feet below ground surface. Maximum drawdown during development was approximately 101 feet and during the constant



rate test was approximately 75 feet bgs. Using the constant rate test, the projected the 30-day and 10-year drawdown is 110 feet and 160 feet, respectively.

Analysis of the recovery data during the constant rate test suggests that the transmissivity of the aquifer is 412 feet/day, and the hydraulic conductivity is between 2.0 and 3.2 feet/day as shown in Figure 4-7.





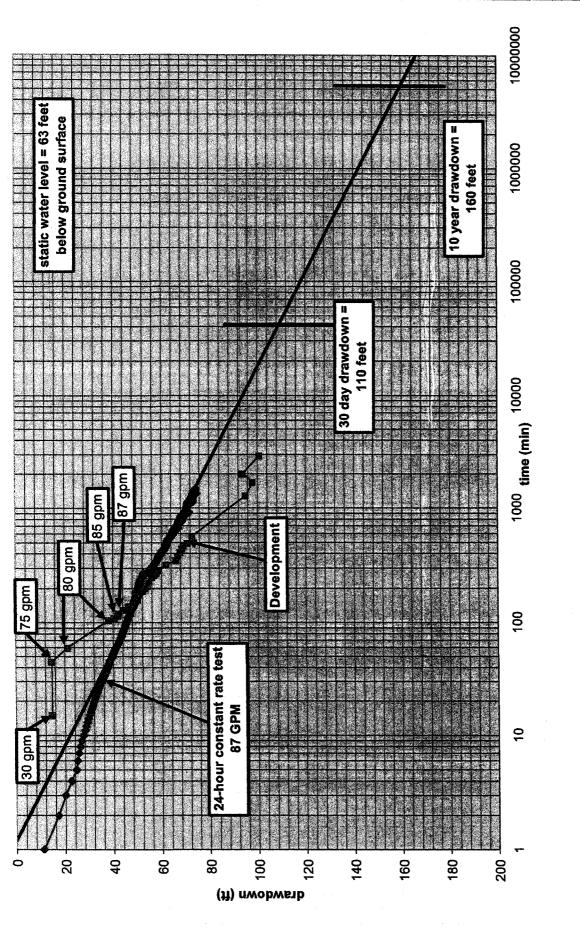
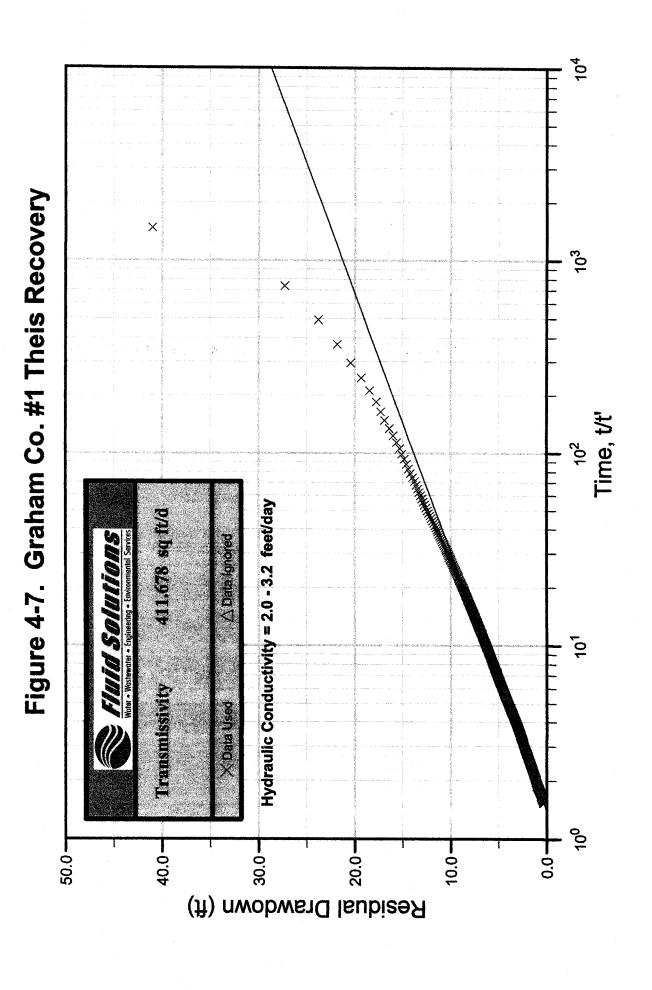


Figure 4-6 – Aquifer Test Results
Well #1

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5.0 Recommended Additional Infrastructure

Additional infrastructure includes the new wells, pumps, transmission lines and power to develop a blending plan that will meet EPA requirements in addition to assisting the Utility in meeting water demands. This also recommends a storage facility that will allow the Utility to deal with well outages out of storage while maintaining water supplies to the customer base. Finally, this address the potential for treatment should the water quality be insufficient to meet the EPA requirements.

5.1 Future Wells

There are three fundamental requirements for future wells installed in the well field property owed by the Utility. First, the well should be drilled to a depth that encounters the thicker sands. In the area of the pilot well, these sands are known to occur from approximately 400 feet bgs to 750 feet bgs.

Secondly, the well will need to be located away from Cottonwood Wash. There is an outside possibility that a 750-foot well drilled near Cottonwood Wash may encounter the thick sands and low arsenic water. However, such a well would be more risky than a well site away from the wash because with time arsenic may be pulled vertically downward into the well. This is one argument against drilling any existing well deeper. If this option were to be pursued, the upper perforations in the existing well would need to be sealed, as required by the Arizona Department of Water Fluid Solutions experience has demonstrated that well rehabilitation can ultimately cost more installing a new well. However, this option could reduce the costs to install water mains and power to the well site. The risk of bringing arsenic-laden water into the new deeper perforations quicker may be resolved by choosing one of the lower arsenic-producing wells, like the Pima #1, to conduct the well rehabilitation. However, Fluid Solutions believes the likelihood of losing a well to arsenic in this area is perceived as much greater than areas away from Cottonwood Wash.

Thirdly, pump rates should not be such to cause migration of the arsenic plume(s) into the new well sites. Pump rates can also be negatively impacted if well spacing is such that the arsenic finds a preferential path through the wells creating arsenic problems one well at a time. It is desirable to keep pump rates from overly stress in the groundwater in the impacted region of the aquifer and keep wells adequately spaced apart to best mitigate arsenic plums.

Because of the uncertainty of the source of the arsenic and the financial limitations of the Utility, Fluid Solutions recommends the following protocol for future well drilling:

 Install one well in an attempt to secure the largest potential well capacity with the lowest possible arsenic concentration for the most



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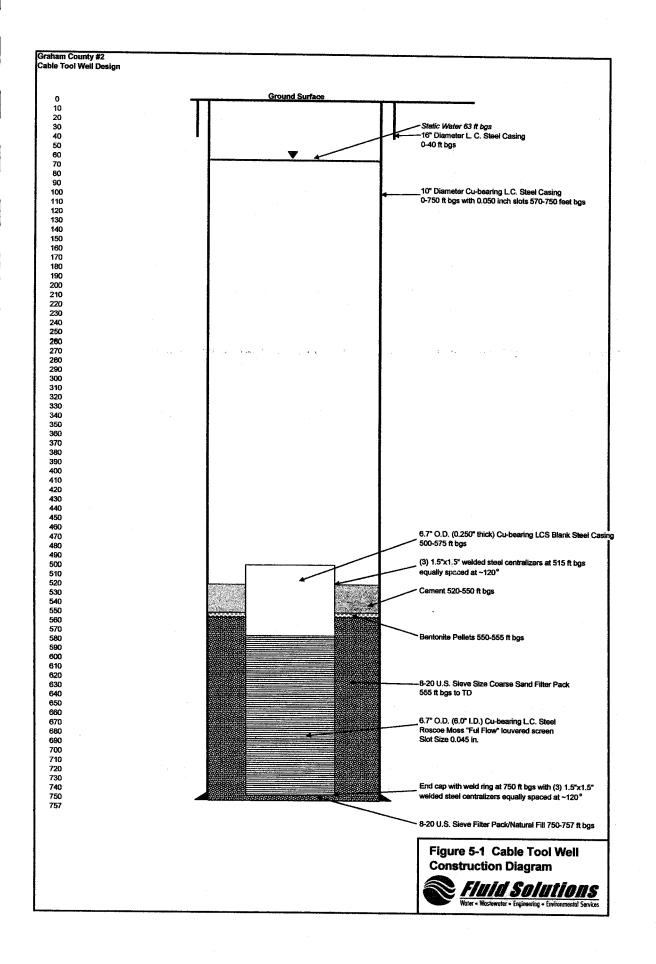
reasonable cost. A 750-foot well appears to have a good chance of finding low arsenic water.

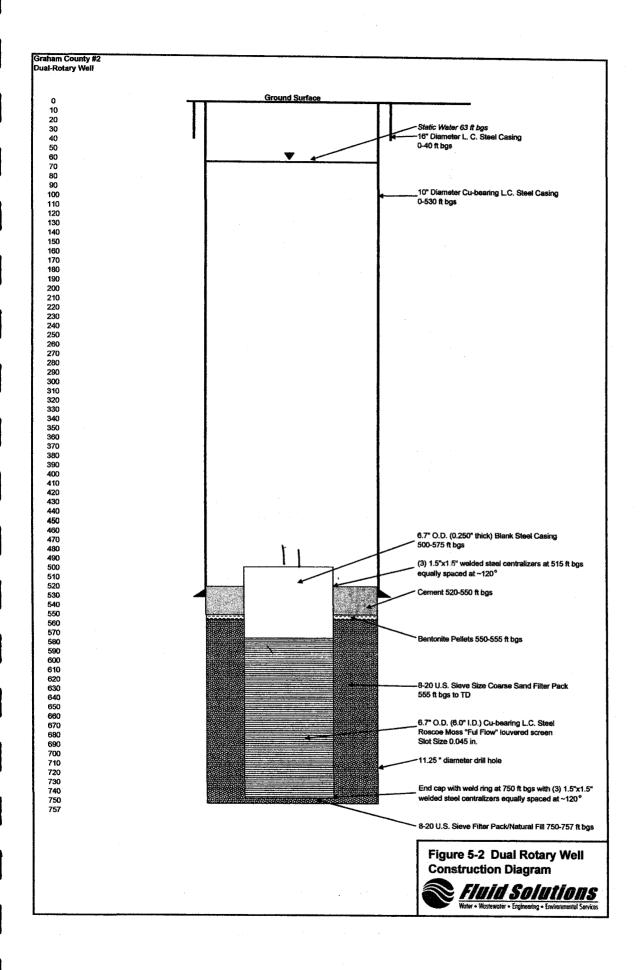
- The lowest risk location for a large capacity, low arsenic well would be a 10-inch cased well within 100 feet from the pilot well. It should be noted that this approach will likely cause the pilot well capacity to significantly diminish and possibly be lost.
- The second best location for such a well would be the proposed well site which is about ¼ mile east of the pilot well as shown on Figure 5-3. It is recommended to take depth-specific water quality samples when drilling and to design the screen based on the water quality results. In order to save on costs, in-hole perforations no thicker than 0.050 inches in width should be cut. If after development, sand production is excessive, it is recommended to install a liner screen with 0.045-inch slot and 8-20 gravel pack as shown in Figures 5-1 for cable tool and 5-2 for dual rotary. Figure 5-3 provides a modified cable tool approach, however, it has construction risks that the other approaches do not have and the Utility must be willing to accept these risks.
- The location for future wells is shown on previously on Figure 4-2. The first choice is Alternate A, followed by Alternate B, and so on. Actual results from each well may impact the desirable next choice.
- Fluid Solutions, at the suggestion of the client, recommends that the third well design (a cable tool approach without a liner, with a gravel pack, and in-hole perforations) will be the best option to fit the needs of the client. This option offers a low cost alternative solution with the potential of the well to produce good quality water at acceptable capacities, but has inherent risks that the client must be willing to accept. These risks include, but not limited to, limited depth specific water quality validity, the potential for sanding, and construction problems relating to the 16-inch casing.

5.2 Blending Plan

The existing wells within the Utility typically have arsenic levels above the new SDW standard of $10~\mu g/l$ as shown in Table 5-1. Data in this table was provided by Utility staff for 2002 and 2003. The data indicates that in many of the wells, arsenic concentrations improved between 2002 and 2003. This could be caused by many factors including lower pumping rates, mitigating watershed impacts, or hydrogeologic formations changing over time. For the purposes of the blending plan we have used the data for 2002 because it represents the worst case scenario.







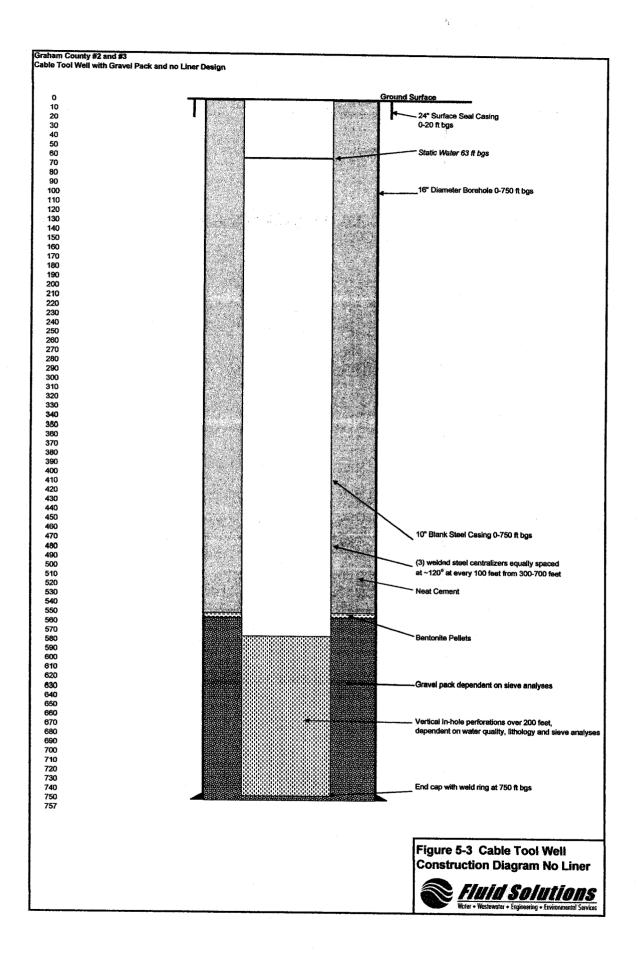


Table 5-1
Existing Well Field Conditions

| Well | Equipped Capacity (gpm) | 2002 Arsenic (ug/l) | 2003 Arsenic (ug/l) |
|-------------------|-------------------------|------------------------|------------------------|
| Pima 1 | 22 | 13 | 6.2 |
| Pima 2 | 64 | 19 | 21 |
| Pima 3 | 37 | 17 | 16 |
| Pima 4 | 38 | 5.5 | 3 |
| Pima 5 | 40 | 17 | 11 |
| Pima 6 | 39 | 29 | 26 |
| Pima 7 | 54 | 37 | 33 |
| Cope 2 | 40 | 10 | 8.7 |
| Two Flow | 25 | 5.7 | 6.7 |
| Magnum 1 | 0 | 4.8 | |
| Herbert 1 | 0 | 66 | 50 |
| Herbert 2 | 0 | 10 | 4-6 |
| Herbert 5 | 24 | 3.9 | 3 |
| Total Capacity | 383 | | |
| Aggregate Arsenic | | 17.72 | 15.69 |

The pilot well drilled exhibited arsenic levels below 2 μ g/l which is within the new standards. Several scenarios were reviewed to determine how many wells were required and how the system might operate with the existing wells. These scenarios are summarized in Table 5-2 and supported by the preliminary plan in Appendix 5.



Table 5-2⁽¹⁾ Minimum Well Requirements

| | New Wells (# at flow) (gpm) | Blended Flow ⁽²⁾ (gpm) | Blended Arsenic Concentration ⁽³⁾ (ug/l) |
|------------|-------------------------------------|--------------------------------------|---|
| Scenario A | 3 @ 100 | 770 | 9.82 |
| Scenario B | 2 @ 150 | 770 | 9.82 |
| Scenario C | 4 @ 100 | 870 | 8.92 |
| Scenario D | 3 @ 150 | 920 | 8.54 |
| Scenario E | 2 @ 150 Pima 7 off | 716 | 7.77 |
| Scenario F | 1 @ 150 Pima 7 off | 566 | 9.30 |
| Scenario G | 1 @ 150 Pima 6 & 7 off | 527 | 7.87 |
| Scenario H | 1 @ 100 Pima 6 & 7 off | 477 | 8.45 |
| Scenario I | No new wells Pima 3,6 & 7 off | 340 | 9.42 |

- (1) Based on 2002 data collected by Utility. This was used to develop a more conservative water quality solution. We recognize that the 2003 data shows a decline in the arsenic concentrations but have not data to support that this phenomenon of declining concentrations will hold over the years.
- (2) Includes 87-gpm contribution from Pilot Well, the existing wells, and the new undrilled wells identified in the table.
- (3) Blending arsenic concentrations were assumed to be $2-\mu g/l$ as was produced in the pilot well. Actual values may vary requiring the blending plan to be adjusted.

The data shows in Scenario I that by equipping the new pilot well and getting in on line by January 23, 2006 the new arsenic requirements could be met. This will require turning off existing wells Pima 3, 6, & 7. The blended arsenic concentration is estimated using the 2002 data at 9.42 μ g/l which meets SDW standards. If the 2003 data holds true and arsenic levels stay down the blended water quality will be 8.22 μ g/l, providing a slightly larger buffer in water quality. The negative side of stopping with this solution is that during the warm summer months the quantity of water is limited while meeting SDW standards.

If one additional well is installed with Pima 6 and 7 turned off, the new arsenic standard can be meet while also adding to the capacity of the system. If the well is 100-gpm, the arsenic is predicted to be 8.45 μ g/l (Scenario H) and if the well is 150-gpm the arsenic is predicted to be 7.87 μ g/l (Scenario G). Both of these scenarios meet the SDW standards while also increasing the water quantity available under the standard. Due to unforeseeable events that can and will occur in a water utility, it is



strongly recommended that another well be drilled as described in this report.

5.3 Pumps, Transmission Lines, and Power

Each well will be fitted with a pump downhole, transmission pipelines to the Utilities chlorination facility, and power systems to operate the pump. Figure 6-3 summarizes how this might all fit together within the existing system.

To the greatest extent possible, we propose using existing infrastructure to meet the new needs. This includes using existing tanks for blending water. Based on the current configuration of the system, that will require two point of entries into distributions system. The first located on the discharge side of the existing 100,000-gallon tank serving a small customer base away from Pima. The second located at the existing storage facilities near Roger's Reservoir serving the balance of the customers.

5.4 New Storage Facility

A blending tank is required to bring each of individual water qualities together to ensure that the desired water quality is attained. This facility must be located prior to entering the distribution system and will become the system point of entry (POE) for regulatory compliance. Currently, the Utility has two existing tank sites that could be used for blending. The first is the existing 100,000 located near the disinfection facilities. The second is the tank farm located near Rogers Reservoir. Due to the nature of the distribution system, both of these sites are required to achieve blending. Both of these tank sites would become POEs for regulatory reporting.

In an effort to increase the overall reliability of the utility is recommended that consideration be given to an additional storage tank. Because the system is spread out and access could be limited at times, a storage facility that would provide an additional day of demands without impacting deliveries is suggested. To meet one day of demands during the summer months, a 500,000-gallon tank would be required. This facility is not mandatory to serve the customer base; however, if it were constructed it would add to the reliability of the Utility.

5.5 Arsenic Treatment

Arsenic Treatment will only be required if the wells drilled do not meet the proposed standard at a level that will allow blending with the existing system to achieve both water quality and quantity needs. Several methods currently exist for removing arsenic from water. These are summarized in Table 5-3 below.



Table 5-3
Arsenic Treatment Technology Alternatives

| Treatment Technology | General Cost Comparison | Arizona Experience |
|----------------------------|-------------------------|--------------------|
| Adsorption Methods | Low to Moderate | Relatively High |
| Coagulation & Flocculation | Low to Moderate | Very Low |
| Absorption Methods | Moderate | Relatively High |
| Membranes | High | High |

Adsorption methods use a media to adsorb the arsenic out of the water as it passed through a vessel containing the media. Capital costs for this solution are kept down by eliminating the waste stream and lost water components of the process. Operations are also kept relatively simple because manufacturers are now offering systems that allow operations staff to exchange the media without handling it eliminating the hazardous waste that can be problematic with arsenic.

Coagulation and flocculation processes use a system that adds chemicals to the water stream, provides for settling and filtration to clean the resulting suspended solids out the stream. This process does have a waste stream but the quantity is small. The greatest downside is containment of the waste stream. However, current pilot activities in Arizona have indicated that it may be a rechargeable material and be non-hazardous. Operations are relatively simple but control logic is somewhat complex.

Absorption methods provide a media that absorbs the arsenic but must be backwashed. It creates a significant waste stream that is hazardous and must be properly contained or sent to a sewer. Operations are similar to adsorption but manufacturers are not removing the hazardous waste from operations.

Membranes are the most reliable process available, but they are also the most complex. There are several membrane approaches that are currently in use in Arizona. These include nano-filtration, reverse osmosis, and electrodialysis reversal. These are all expensive to purchase and operate. Operator training is significant and operator error will likely cause membrane failure costing the utility a significant amount of money to repair the system.

Should Graham County Utilities require treatment, we recommend an adsorption technology where the manufacture works with the utility to handle the hazardous waste. This solution is also the most cost effective at approximately 0.6 dollars per gpm per day with operations costs around 0.15 dollars per gpm per day.



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Should Graham County Utilities require treatment, we recommend an adsorption technology where the manufacture works with the utility to handle the hazardous waste. This solution is also the most cost effective at approximately 0.6 dollars per gpm per day with operations costs around 0.15 dollars per gpm per day.



6.0 Estimated Costs

The following tables summarize the overall costs for the recommended solutions to assist the Utility in resolving both drought and water quality related water resource problems. The first two tables compare a dual rotary well to a cable tool well. Due the fine sands found in the lower aquifer, a screen insert has been included in both estimates to mitigate the sands getting into and damaging the well pumps and other system components. Table 6-1 summarizes a dual rotary drilling approach.

Table 6-1
Estimated 2005 Costs for Minimum Drilling Approach
Using a Dual Rotary Drilling Method
Cost per Well Drilled

| Component | Units | Unit Cost | [| xtension |
|-------------------------------|-----------------------|------------|----|----------|
| Wells | 1 well @ 700-ft | \$ 137,000 | \$ | 137,000 |
| Screen Installation(1) | Screened interval | \$ 48,000 | \$ | 48,000 |
| Well Pumps ⁽²⁾ | @ 30 hp | \$ 22,500 | \$ | 22,500 |
| Power Per Well ⁽³⁾ | 5,000-ft, 3 ph, 480 V | \$ 35,300 | \$ | 35,300 |
| Transmission Line(3) | 5,000-ft @ 4-inch | \$ 40,000 | \$ | 40,000 |
| Capital Sub-total | | | \$ | 282,800 |
| | | | | |
| Engineering | | | \$ | 28,300 |
| Permitting | | | \$ | 7,000 |
| Service Sub-total | | | \$ | 35,300 |
| | | | | |
| 10% Contingency | | | \$ | 31,810 |
| Estimated Total | | | \$ | 349,910 |

- Screen is only require if the alluvium sands in a manner similar to the pilot well. This price includes louvered screen, and appropriate gravel pack to minimize well sanding.
- 2) Based on pump, column pipe, and valving.
- 3) Unit cost basis provided by Graham County Utilities based on their installation history.

Dual rotary drilling will have advantages over cable tool drilling methods in that it will be faster and depth specific sampling will likely be more reliable. If time is not an issue and Utility staff can avoid trying to rush a driller, cable tool drilling will provide an acceptable drilling approach for significantly less money. However, depth specific sampling of water quality may be less reliable due to the time it takes to drill allowing water from differing zones to potentially mix, skewing the results.

Table 6-2 summarizes the minimum well requirements using a cable tool drilling approach. Included in the well cost is a pump test to determine how to best equip the well. Fluid Solutions does not recommend equipping wells with formal pump tests. The test allows the pump size to be maximized against a long-term prediction of drawdown in an attempt to minimize the need of the Utility to relocate pumps before they end their useful life due to dynamic water levels declining into required suction heads for the pump.



Table 6-2 Estimated 2005 Costs for Minimum Drilling Approach Using a Cable Drilling Method Cost per Well Drilled

| Component | Units | Unit Cost | E | xtension |
|-------------------------------|-----------------------|-----------|----|----------|
| Wells | 1 well @ 700-ft | \$ 80,000 | \$ | 80,000 |
| Screen Installation(1) | Screened interval | \$ 48,000 | \$ | 48,000 |
| Well Pumps ⁽²⁾ | @ 30 hp | \$ 22,500 | \$ | 22,500 |
| Power Per Well ⁽³⁾ | 5,000-ft, 3 ph, 480 V | \$ 35,300 | \$ | 35,300 |
| Transmission Line (3) | 5,000-ft @ 4-inch | \$ 40,000 | \$ | 40,000 |
| Capital Sub-total | | <u> </u> | \$ | 225,800 |
| | | - | | |
| Engineering | | | \$ | 22,600 |
| Permitting | | | \$ | 7,000 |
| Service Sub-total | | | \$ | 29,600 |
| | | | | |
| 10% Contingency | | | \$ | 25,540 |
| Estimated Total | | | \$ | 280,940 |

- 1) Screen is only require if the alluvium sands in a manner similar to the pilot well. This price includes louvered screen, and appropriate gravel pack to minimize well sanding.
- 2) Based on pump, column pipe, and valving.
- 3) Unit cost basis provided by Graham County Utilities based on their installation history.

Fluid Solutions agrees with the client that a cable tool approach with a gravel pack, without a liner, and with in-hole perforations is a viable approach, using a local driller and materials. Table 6-3 summarizes a well completion using this approach. This option would better meet the needs of the client if the following two assumptions are met. First, such a cable tool approach will require outer casing to be installed first. This would be followed by installation of the gravel pack and 10-inch casing. Next the outer casing being retracted. If it is not retractable, the outer casing would need to be perforated in place, then the 10-inch casing and gravel pack would need to be installed. The minimum thickness of gravel pack at any point in the annular space needs to be approximately 3 inches. If the outer casing cannot be retracted, the estimated cost of each well will increase; furthermore, a double cased well may decrease well capacity.

Secondly, this approach assumes that the local gravels used will minimize the effects of sand production and that the casing steel is sufficiently resistant to corrosion or incrustation. Sieve analyses will need to be run on the finest sized materials to be screened, and a median size of this material will need to be 4-6 times smaller (in inches) than the median gravel pack size used. Furthermore, the gravel pack size distribution should only allow 10-15% passing the slot size diameter. Water quality needs to be evaluated to ensure the local steel casing used will minimize the corrosion or incrustation potential.



Table 6-3
Estimated 2005 Costs for Minimum Drilling Approach
Using a Cable Drilling Method with Gravel Pack, no Liner, and
Local Driller and Materials

| | | | ###################################### | |
|----------------------------------|-----------------------|-----------|--|----------|
| Component | Units | Unit Cost | Ŀ | xtension |
| Wells ⁽¹⁾ | 1 well @ 700-ft | \$ 38,000 | \$ | 38,000 |
| Screen Installation(2) | Screened interval | \$ 32,000 | \$ | 32,000 |
| Well Pumps ⁽³⁾ | 30 hp | \$ 22,500 | \$ | 22,500 |
| Power Per Well ⁽⁴⁾ | 5,000-ft, 3 ph, 480 V | \$ 35,300 | \$ | 35,300 |
| Transmission Line ⁽³⁾ | 5,000-ft @ 4-inch | \$ 40,000 | \$ | 40,000 |
| Capital Sub-total | | 4 | \$ | 167,800 |
| | | | | |
| Engineering | | | \$ | 16,800 |
| Permitting | | | \$ | 7,000 |
| Service Sub-total | | | \$ | 23,800 |
| | | | | |
| 10% Contingency | | | \$ | 19,160 |
| Estimated Total | | | \$ | 210,760 |

- 1) This price assumes the 16" outer casing is retrievable, used twice, and water samples taken.
- 2) This price includes in-hole perforations in 10" casing and appropriate gravel pack for sanding.
- 3) Based on pump, column pipe, and valving.
- 4) Unit cost basis provided by Graham County Utilities based on their installation history.

The pilot well should also be completed and the associated costs to complete this well are provided in Table 6-4 below.

Table 6-4
Pilot Well Completion
Estimated 2005 Costs

| Component | Units | Unit Cost | E | xtension |
|-------------------------------|-----------------------|-----------|----|----------|
| Well Pumps ⁽¹⁾ | 30 hp | \$ 22,500 | \$ | 22,500 |
| Power Per Well ⁽²⁾ | 5,000-ft, 3 ph, 480 V | \$ 35,300 | \$ | 35,300 |
| Transmission Line(1) | 5,000-ft @ 4-inch | \$ 40,000 | \$ | 40,000 |
| Capital Sub-total | | | \$ | 97,800 |
| | | | | |
| Engineering | | | \$ | 9,800 |
| Permitting | | | \$ | 2,000 |
| Service Sub-total | | | \$ | 11,800 |
| | | | | |
| 10% Contingency | | | \$ | 10,960 |
| Estimated Total | | | \$ | 120,560 |

- 1) Based on pump, column pipe, and valving.
- 2) Unit cost basis provided by Graham County Utilities based on their installation history.



It is likely that as the customer base in Graham County Utilities grows, additional storage for peaking and fire flows will also be required. Preliminary estimates for storage to serve the new and added population that may be served by these new water resources without consideration for fire flows is on the magnitude of 500,000-gallons. Should this be included in the request, a facility that meets the homeland security requirements, SDW requirements, and Utility needs would be required. Table 6-5 summarizes the storage facility costs.

Table 6-5
Estimated 2005 Costs for 500,000-gallon Storage Facility

| Component | Units | Unit Cost | Extension |
|-----------------------|-------------|------------|------------|
| Tank ⁽¹⁾ | 500,000-gal | \$ 425,000 | \$ 425,000 |
| Piping and Valving(2) | | \$ 10,000 | \$ 10,000 |
| Site Security | | \$ 25,000 | \$ 25,000 |
| Engineering & Permits | | 4 | \$ 55,000 |
| 10% Contingency | | | \$ 51,500 |
| Total | | | \$ 566,500 |

- 1) Assumes steel tank on stone base with steel ring. Does not consider tank recycle.
- 2) Assumes tank control is simple altitude type valve or probes.

The final component that may be required but is as yet undefined is treatment. If the wells do not produce the water quality required for the blending plan treatment will be required to meet the 2006 SDW requirements for arsenic. One of the most cost effect solutions is an adsorption approach that does not have a significant waste stream to dispose of. The annual operations cost is between 9 and 10 cents per gallons depending upon the installation requirements for larger installations and between 12 and 15 cents per gallons for smaller installations. Capital costs will range from 0.5 to 0.6 cents per gallon depending upon the piping and control required to make the system operate properly. Assuming a single system is installed at the blending facility, Table 6-6 summarizes the cost potential for treatment should it be required.

Table 6-6
Estimated Treatment Costs

| Condition | Treated Capacity (gpm) | Unit Cost (\$/gal/day) | Extension (\$) |
|-----------------------|---------------------------|---------------------------|-------------------|
| | Only Older Wells | s Require Treatment | |
| Treatment | 383 | \$ 0.6/gal/day | \$ 330,900 |
| Engineering & Permits | | | \$ 43,100 |
| 10% Contingency | | | \$ 37,400 |
| Total | | | \$411,400 |



The operating cost for this type of treatment facility will be in approximately \$82,000 per year. When considered against the capital costs for drilling a new well and equipping two wells, installing treatment is more expensive than either drilling method over the life of the system. Therefore, providing that blending can be cost effectively achieved, it is the recommended solution for this water system.



7.0 Recommended Improvements and Approach

Fluid Solutions recommends that the Utility pursue improvements in three phases on an as needed basis. Funding for each phase shall be independent of each other. The individual phases shall be divided as wells, storage, and treatment. Well improvements shall be the first phase. Additional wells will minimize the need for additional storage today; therefore, storage shall be a separate phase to be pursued on an as needed basis. Treatment should only be pursued if required and that determination cannot be made until the new wells are constructed and tested.

7.1 Phase I Improvements

At this time the wells are the highest priority improvement required by the Utility. Addition of wells will likely improve the water quality to meet SDW standards assuming new wells meet the 2006 arsenic requirements. The pilot well drilled was capable of producing 87-gpm with an arsenic level below 2.0 $\mu g/l$. It is reasonable to assume that the new wells will produce in the 80-gpm range. However, it is not safe to assume that the arsenic levels will be maintained at a low enough level to permit blending with the existing wells to meet the 2006 arsenic standard. It is also not safe to assume that the existing wells will not continue to be impacted by the current trend in declining water levels.

Because of the unknowns as it relates to water quality of new wells and sustainability of existing wells it is recommended that the Utility pursue drilling of six new wells. Assuming that each well produces 80-gpm, six wells will replace the existing non-compliant wells that are becoming less reliable and provide one redundant well to the system. We would also recommend that the pilot well drilled be equipped. Table 7-1 summarizes the budget for this phase.

Table 7-1
Phase One Estimated Budget Costs

| Component | Cost per Unit | Number | Phase Estimate |
|----------------|---------------|--------|----------------|
| Well | \$ 210,760 | 6 | \$1,264,560 |
| Equip Pilot | \$ 120,560 | 1 | \$ 120,560 |
| Total Estimate | | | \$1,385,120 |

This assumes that the 16-inch casing will be usable for a minimum of two wells prior to it becoming cost prohibitive. It also limits on-site observation to only a couple of days requiring Utility staff to monitor progress and collect required samples.

7.2 Phase II Improvements

Phase two may be either the storage or treatment depending upon the actual well water quality collected. This report assumes storage will be



25

phase two with blending capable of meeting short term treatment needs. Table 7-2 summarizes the phase two costs.

Table 7-2
Phase Two, Estimated Budget Costs

| Component | Cost per Unit | Number | Phase Estimate |
|-------------------|---------------|--------|----------------|
| Storage Reservoir | \$ 566,500 | 1 | \$ 566,500 |

7.3 Phase III Improvements

Phase three is only required if the wells do not produce water quality sufficient to meet the 2006 arsenic standards either outright or through a blending plan. Table 7-3 summarizes the phase three costs.

Table 7-3
Phase Two, Estimated Budget Costs

| Component | Cost per Unit | Number | Phase Estimate |
|-----------|---------------|--------|----------------|
| Treatment | \$ 411,400 | 1 | \$ 411,400 |

All costs in the phases shown above are based on August 2005 values. Based on current history, the cost of water utility infrastructure has risen steeply during the past several years. These increases have not trended with cost of living increases as they have in the past. Specific components such as steel have increased upwards towards 70% in a single year due to influences of the world market and China. The Utility should be cognizant of this as the budget into the future.



AFFIDAVIT/PROOF OF PUBLICATION

EASTERN ARIZONA COURIER

301A East U.S. Hwy 70 Safford, AZ 85546 Phone: (928) 428-2560 / Fax: (928) 428-5396

E Mail: mwatson@eacourier.com

Sherry L. English being duly sworn deposes and says: That she is the legal clerk of the EASTERN ARIZONA COURIER. a newspaper published in the City of Safford, Graham County, Arizona; that the legal described as follows:

Shaham County Utilities

Financial assistance

through United States

Opportment of agriculture a copy of which is hereunto attached, was first published in said newspaper in its issue dated Luly 31 and was published in each / issue(s) of said newspaper for / consecutive weeks / issues, the last publication being in the issue dated Signed: Shewy & English

Subscribed and sworn to before me this

day of

Notary Public

My Commission expires: December 29, 2006

NOTICE:

The Graham County Utilities, Inc., Pima, Arizona has applied for Financial Assistance through the United States Department of Agriculture (USDA) Rural Housing Service - Facilities Community Programs for special project funding. There will be a public information meeting on Thursday, August 11th, 2005 at the Graham County Electric Coop/Graham County Utilities Board Room located in the office building at 9 West Center, Pima, Arizona beginning at 2:00pm. The purpose of meeting is to acquaint the general public with the proposed project and to consider environmental and economic impact.

Req.: Graham County Electric Coope<mark>rative, Inc.</mark> Published July 31, 2005 in the Eastern, Afizona, Courier, Safford, Afizona 85546. Form RD 1942-8 (Rev. 2-98)

Position 5 UNITED STATES DEPARTMENT OF AGRICULTURE RURAL DEVELOPMENT

FORM APPROVED OMB NO. 0575-0015

RESOLUTION OF MEMBERS OR STOCKHOLDERS

| | Grah | am County U | tilities | , Inc. | | | | | |
|---|--|---------------------------------------|---|---|------------------------------------|-------------------------|--|----------------------|---|
| | | | | (Name | of Association) | | | , | |
| | P.O. | Drawer B | Pima, | Arizona | a 85543 | | | | |
| , , , , , , , , , , , , , , , , , , , | | | | (Address, | including Zip Co | de) | ************************************** | | |
| | | nat the Governing propriate — | Board of thi | s Associatio | on be and it hereb | y is author | rized and | d empowered to | o take all action |
| 1. | | for and on behalt ental agency: | f of the Assoc | ciation throu | ugh the United St | ates Depar | rtment o | f Agriculture (| USDA) or any other |
| | (a) A | loan in a sum not | to exceed \$ | 1,100, | ,000.00 | ; | | | |
| | (b) A g | grant in a sum not | to exceed \$ | 969, | ,620.00 | ; | | | |
| | | anced by the lend | | | | such time | or times | as may be agre | ed upon. |
| 2. | (a) For the may (b) For the as ev | be required: | ch application delivery to the an or grant; a | ne lender or | grantor of all suc | | | | plements thereto) as required in regard to or |
| 3. | (a) To ol as th (b) To p owne such | e Governing Boar ledge, hypothecat | d shall deem e, mortgage, quired, as sec | proper; convey, or a curity for any | assign property of a signification | f this Assons (past, pr | ciation o | of any kind and | ner terms and conditions I in any amount now this Association to |
| | | | | CERT | TIFICATION | T | | | |
| Ì, tl | ne undersig | ned, as Se | cretary | | | | of 1 | the above name | ed Association, hereby |
| | | | , | • , , | cting Secretary) | | | | |
| certify th | at said Asso | ociation on the | 3rd | d | lay of August | t ——— | | 006, had | 9 (Number) |
| | Dimo | | _4_ | | | | | - | |
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| | , | | o) or (snares | • | _ | | C - | | |
| constitute | ed a quorun | n; that | | said mei | nders or stockno | iders or sn | ares of v | oung stock we | re present at a meeting |
| of the me | mbers or st | ockholders duly o | alled and hel | d on the | 3rd | | day of_ | August | , 2006; |
| that the fo | oregoing re | solution was adop | ted at such n | neeting by the | he affirmative vo | te of | | 9 | said members |
| or stockh | olders or sh | ares of voting sto | ck; and that | said resoluti | on has not been r | rescinded o | or ameno | led in any way | • |
| Dat | ed this day | : | 3rd | of | August | | , 2 | 006 | |
| | | | | | Senalo | 126 | 76 | Je rald : | L. Kempton |
| | | | | | Secretary of_ | Grah | nam Co | | ities, Inc. |
| | | | | | | | | | |

According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0015. The time required to complete this information collection is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

GRAHAM COUNTY UTILITIES, INC. - WATER SOURCE OF FUNDS TO SERVICE NEW RURAL DEVELOPMENT DEBT

SOURCE OF FUNDS TO MAKE NEW LOAN PAYMENTS

| Depreciation & Amortization | 104,500.00 | *** |
|---|------------|-----|
| Principal Payments on Long-Term Debt | 82,139.00 | *** |
| Excess of Depreciation over Principal Payments | 22,361.00 | _ |
| Net Margins | 46,905.00 | *** |
| Cash Available for New Loan Payments | 69,266.00 | _ |
| INCREASE IN LOAN PAYMENTS | | - |
| New Rural Development Monthly Loan Payment | 4,996.00 | |
| Less: old CFC Construction Loan Refinanced by Rural Development | 1,034.01 | _ |
| Net New Loan Monthly Payment | 3,961.99 | • |
| Months | 12 | |

*** LATEST AUDITED REPORT 9/30/05

Net New Annual Increase in Loan Payments

A prior construction loan with CFC of approximately \$128,000 @ 7.45% will be refinanced by Rural Development @4.375% as part of the \$1,100,00 loan.

47,543.88

We do not anticipate a need to increase our water rates because the excess of depreciation and amortization exceeds our principal payments by \$22,361 and our net margins are \$46,905 for a total of \$69,266. This exceeds our new increase in loan payments of \$47,544.

Preliminary estimates to comply with the new arsenic standards were \$25 to \$30 per consumer per month.

We feel this is the correct approach to take to comply with the new stricter arsenic standards and provide for adequate water for our consumers in the future without raising rates.